

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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VOLUME VII

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R & S TYPING SERVICE

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P R O C E E D I N G S

8:30 a.m.

1
2
3 THE COURT: We're on the record, everybody.

4 Good morning. It's November 20th, yet another
5 beautiful day in Seattle. It's the seventh day of our
6 hearing, and we're going to resume with the cross-
7 examination of Mr. Heerspink. But before we do, I want to
8 just tell you two little announcements. One, is that we're
9 being tossed out of this room at 5:00 o'clock today, but
10 we've made arrangements to move upstairs for another hour
11 or two afterwards. So we'll probably at about 4:00 o'clock
12 or so when I call the regular afternoon break, we'll just
13 reconvene at a room upstairs. They're going to get back to
14 me on that later in terms of the exact details. But we're
15 definitely out of this room at 5:00 o'clock, so I know
16 everyone wants to go a little bit later than that, right?

17 And also, I think tomorrow morning since it's
18 going to be a short session, we probably should just start
19 at 8:00 o'clock, unless that's a hardship, people go from
20 about 8:00 to 11:00, no later than 11:15. Some of us are
21 on a 12:45 flight, and I don't know what other people's
22 schedules are, but I plan to be on my flight.

23 So --

24 MR. YALE: The issue would be one of scheduling
25 the number of witnesses.

1 THE COURT: Right.

2 MR. YALE: I mean, we will probably -- the way
3 things are going, I think that's one witness, but we will
4 try to have two available tomorrow. I think that that
5 probably will fill that period up.

6 THE COURT: I can't -- the way things are going,
7 if we go through two full witnesses in three hours, I'd be
8 stunned.

9 MR. YALE: I would, too, but I think -- if they
10 did, I'd just -- if we got that in two, I hope the Court
11 won't be upset if we have an hour that early, because I
12 don't think (inaudible).

13 THE COURT: I -- you know, I can't even imagine
14 that, okay. I can't even imagine it.

15 Okay. Who is next to cross-examine or to
16 question Mr. Heerspink? Mr. Marshall, is going to take
17 care of it?

18 That was Mr. Yale that I was having that little
19 colloquy with before just for the record.

20 MR. MARSHALL: For the record, this is Doug
21 Marshall, of Northwest Area Association.

22 ROB HEERSPINK, WITNESS, PREV. SWORN

23 EXAMINATION

24 BY MR. MARSHALL:

25 Q. Good morning, Rob.

1 A. Good morning.

2 Q. Yesterday in your testimony you described
3 yourself as one of the owners. Were others, any other
4 owners be testifying at this hearing on behalf of Edaleen
5 Dairy?

6 A. I -- possibly, yes. I don't know that for sure.

7 Q. Well, the dilemma that I have is that I know you
8 are responsible for the farm operation, but --

9 A. Right.

10 Q. -- you did cover some of the marketing issues.
11 I'll just ask you the questions I have and if you wish to
12 defer them -- excuse me. If you wish to defer them to
13 another witness --

14 A. Okay.

15 Q. -- then that's fair.

16 I gathered yesterday that you did not want to
17 reveal the size of your operation, at least by cow numbers;
18 is that correct?

19 A. That is correct.

20 Q. But would you agree with me that yours is serving
21 one of the largest farms in northwestern Washington?

22 A. I'll agree to that.

23 Q. I believe you've seen the prepared testimony of
24 Bill Van Dam, and included within that -- have you seen
25 that?

1 A. Yes, I have.

2 Q. But have you --

3 A. If we're going to go into great detail, I'm going
4 to need a copy.

5 Q. In that testimony there was a list of plants, and
6 his estimates of volumes. Do you have any disagreement
7 with any of the numbers that are in there?

8 A. I have no personal dealings with any of those
9 other plants. Ours is in the neighborhood of being
10 correct.

11 Q. Let's help the people from out of town by
12 describing a little bit about this region. Would you agree
13 that Whatcom County is one of the Pacific Northwest's
14 largest milk producing counties?

15 A. Yeah, I'll agree.

16 Q. And you're located in what Whatcom County?

17 A. Correct.

18 Q. And then there's one county to the south known as
19 Skagit County, which is also a good milk shed, right?

20 A. Yes.

21 Q. And then you begin, as you move into the next
22 county south, you'd begin to hit the metropolitan area,
23 correct?

24 A. Correct.

25 Q. And you're about a hundred miles from Seattle

1 ballpark?

2 A. Yeah.

3 Q. My recollection from driving around Whatcom
4 County, is that you all have two parlors and the original
5 one near your processing plant and a newer one that's a
6 mile or so away; is that accurate?

7 A. That is accurate.

8 Q. During Mrs. Costner's (phon.) testimony she
9 talked about her company's transportation costs to haul
10 milk from their farm over in central Washington State to
11 their plant in Kent. You don't have that kind of
12 transportation costs, do you?

13 A. The parlor you're referring to back on, has been
14 retired to a hospital parlor only. There is no Grade A
15 production in that parlor, so all of our milk is
16 transported from the main dairy to the processing plant by
17 way of truck.

18 Q. Okay. Then the parlor near the -- the older
19 parlor near your processing plant is the hospital pen --

20 A. Correct.

21 Q. -- parlor, and the new facility that's a mile or
22 so away --

23 A. Correct.

24 Q. -- is where your milk to be bottled is milked and
25 that's about a mile away, so you have the transportation

1 cost of bringing it each load over to the --

2 A. Correct.

3 Q. -- processing plant.

4 A. Correct.

5 Q. About a mile?

6 A. Correct.

7 Q. Do you know what your hauling costs are per
8 hundred weight basis?

9 A. Proprietary. I'm going to call that proprietary.

10 Q. Proprietary?

11 A. Yeah.

12 Q. I'll represent to you that our and the E-member
13 producers in your neighborhood are charged roughly 40 cents
14 a hundred weight for hauling depending on their volume. Is
15 your hauling expense anywhere near 40 cents a hundred
16 weight?

17 A. I can't answer that.

18 Q. Do you contend that there is anything about your
19 producer handler operation that causes you to have any
20 greater hauling expense, than others who are pooled to
21 producers?

22 A. No.

23 Q. Yesterday in your discussions with Mr. Yale on
24 the record, you talked about butterfat production and the
25 difficulty of adjusting your herd butterfat production. I

1 missed the relevance of that, other than to perhaps rebut
2 Dr. Smith. I understood you to say that you are not trying
3 to minimize your herds' production of butterfat; is that
4 correct?

5 A. That is correct.

6 Q. So it's not one of your goals?

7 A. No, it is not.

8 Q. Would you agree with me that there is a vibrant
9 market for surplus cream in the Pudget Sound and in the
10 Pacific Northwest?

11 A. Like Mr. Beshore asked me, I don't know about the
12 cream pricing or the sales ability.

13 Q. Do you know how you dispose of surplus cream?

14 A. No, I do not.

15 Q. Do you believe you have any additional costs of
16 balancing because of surplus cream?

17 A. I do not know the answer to that.

18 Q. Yesterday you testified that sometimes your cost
19 of production is greater than the blend price.

20 A. That is correct.

21 Q. The community that you're in around Linden,
22 Washington is kind of a dairy area, as I believe you
23 testified already. You talked to your neighbors about
24 whether they're able to cover their cost of production on
25 the blend price.

1 A. Yes, I have.

2 Q. And what is your view as to their ability to do
3 that?

4 A. There has been a community sentiment that the
5 prices are difficult to operate at.

6 Q. You bet.

7 A. Yeah.

8 Q. I sure agree with you there.

9 Do you believe you have any greater because -- do
10 you believe that your status as a producer handler makes it
11 anymore difficult for you to -- would make it more
12 difficult for you to operate in this current dairy -- book
13 price dairy environment than for pool producers who are
14 your neighbors?

15 A. Be more specific.

16 Q. I'm asking if --

17 A. Are you talking on the farm gain only?

18 Q. Well --

19 A. I mean, as a whole enterprise that changes the
20 dynamics.

21 Q. I understood, and I was trying not to fuzz that
22 up like that, so let me withdraw that question and try to
23 ask you a more direct question.

24 Is there anything unique to your status as a
25 producer handler that makes it more difficult to survive in

1 the current price environment?

2 A. Yes, as a producer handler.

3 Q. And what would that be?

4 A. In supply management.

5 Q. Let's stay with the blend price for just a
6 second. If your family were to decide to spin off from its
7 business, one or both of your farms into a separate
8 organization, and if that organization were pooled, could
9 that farm survive economically over the long-term on the
10 Pacific Northwest order blend price?

11 A. I've not taken the time to do the financial
12 analysis of that.

13 Q. If you will, come back to that one point where
14 you mentioned on supply management in a minute.

15 A question about the protocols that you described
16 yesterday to Mr. Yale that you follow to prevent antibiotic
17 contamination. Are those -- I think you testified those
18 protocols are not unique. Aren't those the protocols that
19 are actually recommended by the industry, and particularly,
20 by the state veterinarian?

21 A. That would be correct.

22 Q. Did you testify -- well. I'm not sure whether I
23 heard you say, so I'm going to ask you now. Do you believe
24 that your costs of dealing with the potential for inner
25 contamination are greater than other pool producers?

1 A. As a whole company, yeah.

2 Q. Okay. Well, let's break that down.

3 How are your costs different than any of your
4 neighbor producers and then we'll ask the same question
5 about any other bottling plant?

6 A. Okay. The neighboring producers, I would expect
7 and like I said yesterday, I've never seen an actual
8 contract of what the repercussions would be, but in the
9 assumption that the dairyman is going to be responsible for
10 the tanker or the contaminated milk that he's attributed
11 to, I think the responsibility would be similar at that
12 point.

13 Q. Okay. And, in fact, it could be more for a
14 smaller producer, could it not, more of an impact to have a
15 positive antibiotic test? Let me explain that --

16 A. Yeah.

17 Q. -- I guess by asking a question. You have a
18 neighbor directly to your south, the Smith farm, that I'll
19 represent to you ships about one load, full load of milk
20 every other day.

21 If they were to have a positive antibiotic or if
22 any producer ships one load every other day, would it have
23 a positive antibiotic test at the receiving plant that milk
24 had to be dumped, they would be losing two days production,
25 would they not?

1 A. I would certainly have the potential of the same
2 responsibility.

3 Q. But you wouldn't be losing anywhere near two days
4 production if you found one tanker that was positive.

5 A. I have that potential with the silos and weekend
6 storage, holiday storage, windows are full and for one of
7 those storage silos on my farm.

8 Q. One of the farm silos?

9 A. Yes. I have two-day storage on my farm.

10 Q. Is that any different throughout any other large
11 producer, the silos on their farm?

12 A. I would think there's lots of unique situations
13 out there. I'm assuming that a lot of the storage is
14 geared toward the 70,000 pound trucks that we were talking
15 about earlier. With that assumption, you know, there's
16 going to be units of storage at varying different farms,
17 whether that farm wants to continue on daily pickup, or
18 and/or every other day. I don't know all the situations of
19 the large producers and their storage. I can speak to mine
20 that I do have two-day storage on my farm.

21 Q. And you don't -- and that's one reason why you,
22 like many producers, have procedures in place to ensure
23 that no milk goes into your farm silo, milk from a cow
24 that's still positive for --

25 A. That would be the reason for that.

1 Q. And you'd agree with me then that is similar to
2 the situation faced by other large producers who have silos
3 on their farm.

4 A. Correct.

5 Q. Now, --

6 A. Similar to the Schmidt farm that we were talking
7 about.

8 Q. Yes.

9 A. Yeah.

10 Q. Yesterday we talked about -- you talked with Marv
11 Beshore about the potential for using that kind of
12 contaminated milk as calf feed, and I believe you explained
13 you didn't want to do that because of concern that it might
14 get mixed into the Grade A stream.

15 In that respect, are you different than other
16 producers?

17 A. In the fact that we made a decision that do not
18 want to store that milk at any capacity, whether in bulk
19 systems or five gallon buckets. It's different then to the
20 dairyman who so chooses to feed it to his cows, so at that
21 point he will have stored it.

22 Q. Okay. Let me -- that's a fair answer to my
23 question. Let me be more specific about my question.

24 A. Okay.

25 Q. If there is a risk on your farm from potentially

1 feeding antibiotic contaminated milk to calves, which is
2 perfectly legal, right?

3 A. Correct.

4 Q. If there's a risk to you in doing that, doesn't a
5 producer who elects to do that have the same risk?

6 A. Correct, and I'm just speaking to my management
7 choice. I've chosen not to pursue that avenue.

8 Q. And do you contend that that management choice
9 gives you any higher cost than anyone else?

10 A. Yes, it would, in my replacement cost.

11 Q. Do you feel then that because you're a
12 producer/handler you have a higher cost of raising your
13 replacement heifers because you elect not to feed them milk
14 from -- that's been contaminated with antibiotics?

15 A. If we're talking just isolated heifer
16 enterprises, yeah, I would contend that.

17 Q. Is that because of your status as
18 producer/handler, or is that because of --

19 A. No, that is one of the main reasons that we have
20 gone to that policy, yes.

21 Q. But you also acknowledge that any other producer
22 has the same risk that you've chosen to --

23 A. On the farm side, yes.

24 Q. And so as a non-producer/handler, that producer
25 deals with the same cost associated --

1 A. If he so chooses to take the risk with his
2 employees, then that is --

3 Q. It's a management decision, right?

4 A. That is correct.

5 Q. It's nothing to do with the status of a
6 producer/handler?

7 A. In our situation, I feel it is.

8 Q. Fair enough.

9 The other -- excuse me. As part of that same
10 dialog with Mr. Beshore yesterday, I believe you said that
11 you felt the key point about antibiotics and potential
12 contamination is that you don't have the ability to order
13 another load.

14 Did I understand -- did I misquote you? Is that
15 your testimony?

16 A. Yes. I would suspect that. I -- yeah. I did
17 say something to the fact that I cannot get milk to replace
18 that contamination.

19 Q. In that respect, is your situation as a
20 producer/handler different than any other processing plant?

21 A. I would suspect, yes.

22 Q. And why would your situation there be different
23 than any other regulated processing --

24 A. My own farm storage capacity is right at three --
25 well, one of the silos is a 20,000 gallon silo, and that's

1 a little over 200,000 pounds capacity. And if that were to
2 be contaminated and I lost that milk, legally I cannot get
3 that milk replaced.

4 Q. Legally you can't get that milk replaced?

5 A. If I wanted to maintain my handler/producer
6 status.

7 Q. So there would be a cost to you of incurring a
8 lost farm silo that you feel is unique because of the
9 regulations?

10 A. Is unique in the fact that I have no other
11 producers that I can solicit that amount of milk to our
12 operation to in-state as a handler/producer. Where a group
13 of pool plants have the opportunity to ship milk from one
14 class use to the other to fill the orders of that day for
15 the customer.

16 Q. Well, those other plants that you've described,
17 they would have a cost of replacing that milk at some
18 point, do they not?

19 A. I would expect it would be a transportation
20 adjustment, diverting one load to a plan and then vice
21 versa when the production would allow to replace that back
22 to the other plant.

23 Q. And what would be the cost to the diverted -- to
24 the plant from which the milk is diverted. Wouldn't that
25 balancing plant being incurring additional costs by not

1 having that tanker that had to be given --

2 A. I'm not that -- I'm looking from a transportation
3 standpoint. I'm not -- have not ever been in management of
4 a plant to know what it's storage capacity, bumper capacity
5 from Sundays, what your days of operations are, and what
6 day of the week happens.

7 There's a multitude of factors that would play
8 into that.

9 Q. Well, if you --

10 A. And I'm not that familiar with the processing
11 industry to truly answer your question that way.

12 Q. Yeah, that poses a dilemma that day, because you
13 are asserting a greater cost in your case, for that
14 balancing, and yet you're saying you don't understand our
15 balancing costs.

16 And so I'm going to ask some questions and if you
17 don't know, you best say you don't know.

18 A. Let me think here. Repeat that question one more
19 time.

20 Q. Well, as a comment as to warn you where we're
21 going to with future questions.

22 You're testifying that you believe you have a
23 greater balancing cost because of your producer/handler
24 status, and yet, you're also saying you don't understand
25 the balance of cost that effect the regulated pool producer

1 and pool plant.

2 So I'm going to ask some more questions that do
3 have to explore the relationship between your cost and our
4 costs. If you don't know, you don't know, but that's the
5 dilemma that we face.

6 A. Well, I can speak to the end use customer. I
7 have no situation of delivering that milk that day to the
8 customer. Where a pool plant would have opportunity to get
9 milk from another source that day.

10 Now, whether -- I will not be able to speak to
11 the exact cost of that pool plant, but I will be able to
12 feel comfortable saying you have a better chance of
13 supplying that customer's milk that day and not lose that
14 customer for a non-delivery.

15 Q. Okay. Well, let's assume --

16 A. Where I have that.

17 Q. Let's assume that the regulated plant doesn't
18 want to lose the sale either and needs to serve the
19 customer just like you do.

20 A. Correct.

21 Q. Then I suggest to you that it's just a matter of
22 cost. You could replace the milk at some cost, could you
23 not? In other words, --

24 A. Well, --

25 Q. Let me finish my question.

1 A. Okay.

2 Q. Just let me -- I'm trying to do it slowly and I'm
3 not trying to trick you up here. I think you're better off
4 just listening to the question.

5 If you chose to buy milk from other sources in
6 order to maintain the sale, you would have the cost that
7 you described of becoming regulated that month. So there's
8 a dollar sign figure that's telling you you don't want to
9 do that.

10 A. That's correct.

11 Q. Similarly, there's a dollar sign figure
12 associated with a similar situation in a regulated plant.
13 That dollar sign figure may or may not be greater or less
14 than your dollar sign.

15 A. I can't speak to that.

16 Q. Okay. But you acknowledge there would be some
17 costs to the regulated plant and/or to its supplier.

18 A. That is correct.

19 Q. Thank you.

20 You're the farm manager there at Edaleen Dairy
21 and are familiar with environmental and related regulations
22 that put a maximum number of cows, effectively put a
23 maximum number of cows in which -- that you can have on
24 your facility.

25 Yesterday I think you testified that you were at

1 your permit limit.

2 A. That's correct.

3 Q. Do I understand you correctly to be referring to
4 the -- to a purvent that's issued for environmental reasons
5 to limit the number of cows?

6 A. Yes, that's correct.

7 Q. So within your current facility, you're
8 testifying that you're currently pretty much at your limit,
9 and you and Mr. Yale were talking yesterday about the
10 Starbuck's account. You talked about the difficulty of
11 moving your volumes of process milk up to meet new demand.

12 A. Uh-huh.

13 Q. And then the difficulty of backing off when you
14 lost that account.

15 On the way up then, let's focus on that side for
16 a minute.

17 A. Okay.

18 Q. And your situation with your current permit.

19 First of all, it's true, isn't it, that you could
20 have chosen on that way up to buy outside milk and become
21 regulated for a few months while you were building up your
22 own herd, you could've chosen to do that, right?

23 A. Yes, that is an option.

24 Q. So it's just a question of cost.

25 A. Well, there's more factors to that. I mean, your

1 commitment to your customers, your cost, your market.

2 Q. The commitment to the customers being what again?

3 A. The glass -- I mean, the whole control of our
4 milk supply.

5 Q. That's one of the way you market your milk is the
6 control that you have, right, is that what you're
7 testifying?

8 A. Yes.

9 Q. Now, is that a strategy that you're required to
10 have as a producer/handler, or is that a strategy that you
11 elect to have and the way you work --

12 A. You're right.

13 Q. Pardon me?

14 A. That is a strategy we elected.

15 Q. And that's not mandated by the producer/handler
16 regulation or status.

17 A. To market our milk essentially.

18 Q. Right. You're shaking your head no.

19 A. No.

20 Q. Don't you agree with me?

21 A. Correct.

22 Q. All right. So you elect not to buy milk from
23 outside during your growth curve, but you have another
24 option that I would suggest to you to grow fairly rapidly,
25 if you wished. Is it not true that all over Whatcom County

1 there are farms, dairy farms -- farms that were Grade A
2 diaries that have gone out of business? Have you ever
3 explored whether it's possible to lease any of those
4 existing facilities that's not being currently used?

5 A. I understand your question and I want to share an
6 experience that just happened a couple of weeks ago.

7 Q. Sure.

8 A. There is a -- in the neighborhood, there was a
9 dairy fire and the producer, I'm assuming is a member of
10 NMA, and the community came together and with his barn
11 fire, he had to release his animals out in the field and
12 everybody showed up with their livestock trailers and
13 wanted to help this guy out. And we spent, just by
14 estimation, close to four hours, trying to locate a
15 facility that could accommodate -- he has about 250
16 animals. The difficulty in that, was that there was only
17 one or two -- well, there was about two or three different
18 facilities that have potential.

19 Two of those three facilities refused to let
20 those animals in, even in a hardship case. We were able to
21 get one facility in Ferndale, which took quite a bit of
22 coercion to get, but fortunately it did happen.

23 So the idea that that is easily available, I
24 think is kind of misnomer, even though there is a lot of
25 facilities empty.

1 Q. Well, by the way, Ferndale, you referred to
2 Ferndale, it's a neighboring town, about ten miles away.

3 A. You bet, it's ten miles away.

4 Q. In that emergency situation and I appreciate your
5 assistance to that farmer, one of the issues that would've
6 had to been addressed was to find a facility where he could
7 milk the cows, right?

8 A. That is correct. My situation would be the same.

9 Q. Okay. Well, let's back up a second here. One of
10 the requirements for milking a cow is to have a Grade A
11 permit.

12 A. Yes.

13 Q. And probably those vacant facilities would have
14 to have some work done on them before they could be
15 upgraded to renew their Grade A permit, right?

16 A. Well, I -- and I can't speak for USDA, but I
17 would think that they would be willing to work with an
18 individual that way.

19 Q. Well, I mean, in general. If a facility stood
20 idle, you'd have to do a little bit of work to try to bring
21 it up to correct standards as in renewing this permit,
22 there'd been some --

23 A. Yeah.

24 Q. -- cost to that, right?

25 A. Yeah.

1 Q. And so in a situation unlike the barn fire
2 emergency, but --

3 A. Uh-huh.

4 Q. -- a situation where you knew you had potential
5 business coming, you'd be in a little bit different
6 situation than if you'd had a barn fire. You would have
7 the opportunity, would you not, to --

8 A. Yeah, the timeline would be different, yes.

9 Q. And you'd have the opportunity to talk about a
10 lease in terms for getting the thing up to pass a Grade A
11 permit inspection.

12 A. Yes.

13 Q. You could also lease cows, could you not, to
14 expand rapidly?

15 Let me rephrase the question.

16 A. Yeah.

17 Q. Is cow leasing common in our region?

18 A. Typically not. It is done, but it's not common.

19 Q. I'm suggesting to you that you could lease a
20 place and lease cows and expand fairly rapidly at a fairly
21 low cost. Have you ever explored that option in that
22 situation that you described to Mr. Yale yesterday, when
23 you had a potential new customer?

24 A. Yes, I have.

25 Q. Do you think it is feasible to do that?

1 A. The opportunity was not available to us when we
2 explored that option.

3 Q. Okay. Let's talk about -- that was the growth
4 phase. Let's talk about the down phase.

5 You described the loss of the Edaleen business
6 that you had with Starbuck's to Safeway.

7 A. Yes.

8 Q. And just so the record's clear, that was commonly
9 believed, and it may have been testified to in Phoenix, but
10 that was tied to an arrangement by which Safeway also put
11 Starbuck stores into many of their -- within many of their
12 larger Safeway stores; is that true?

13 A. The information we received never mentioned that.

14 The information we received was due to pricing
15 and the ability to distribute up and down the I-5 corridor.

16 Q. So you lost that business. Now, -- and you
17 described the problem that created for you. But that
18 problem that created -- was created for you when you lost
19 the Starbuck's any different than the problems that
20 Sunshine Dairy faced as Mr. Arbuthnot testified to in
21 Phoenix, when he had lost the Starbuck's account to you.

22 A. One thing that comes to mind that would be
23 different is Mr. Arbuthnot would've had an opportunity to
24 cancel ordered milk, where I have no -- the cows keep
25 producing each day.

1 Q. What about the cows that have been supplying Mr.
2 Arbuthnot, didn't they continue to produce each day?

3 A. Mr. Arbuthnot does not have his own production,
4 does he?

5 Q. I'll represent to you that Mr. Arbuthnot's
6 company, Sunshine Dairy, had been supplied by a cooperative
7 known as Portland Independent Milk Producers.

8 A. That is correct.

9 Q. Does that jog your memory?

10 A. Yeah. I didn't want to make assumptions.

11 Q. Okay.

12 A. At that point, I don't think that Mr. Arbuthnot
13 himself took the financial cost of the over-production of
14 those cows that you're referring to.

15 Q. I'm sorry, I didn't follow you. Could you repeat
16 that?

17 A. Sunshine Dairy, Mr. Arbuthnot, I don't think
18 would have the burden of the cost of the cattle that
19 produced the over milk in that situation.

20 Q. So you're suggesting he was able to shift that
21 burden to his cooperative supplier, Portland Independent?

22 A. Yes.

23 Q. Do you think that Portland Independent had any
24 charge in its price relationship to Sunshine to accommodate
25 that risk?

1 A. I would not have that information.

2 Q. Well, your -- are you aware whether Portland
3 Independent does not have any plant of its own with which
4 to process that milk that was not needed by Sunshine?

5 A. I had assumed that.

6 Q. And so you assumed that in your answer --

7 A. In the fact that Mr. Arbuthnot would have not
8 assumed the over-production cost of the cattle that you're
9 referring to.

10 Q. Okay. I believe you said you believe you shifted
11 -- he was able to shift that cost to Portland Independent.
12 Are you aware that Portland Independent does not have a
13 plant into which to put that additional milk that was
14 suddenly backed into them, by the loss of Sunshine's --

15 A. Whether they have a plant or not, I think that
16 the Portland Independent absorbed the cost of the over-
17 production, not Mr. Arbuthnot.

18 Q. You said you don't know if that was covered in
19 the price structure, right? You don't know if --

20 A. I do not know what their contract said, no.

21 Q. But you know that Portland Independent had to
22 find another market for that milk, right?

23 A. Yes.

24 Q. How was Portland Independent's situation any
25 different from yours after -- in each case, the Starbuck's

1 business is lost?

2 A. At that level, I think there would be some shared
3 cost, yeah.

4 Q. And, in fact, they might've had to sell their
5 milk to us at \$1.50 under class -- lowest class price, just
6 as you would've, right?

7 A. If you say so, then, yeah.

8 Q. Certainly it was one of their options, right?

9 A. Yeah.

10 Q. So, in that respect, no difference, because they
11 didn't have a plant of their own.

12 A. Correct.

13 Q. More alternatively, if that was not an option,
14 they could have worked with Sunshine to bottle that
15 additional milk and go sell it at other cheaper prices in
16 the marketplace, right?

17 A. That would -- repeat your question.

18 Q. It's possible if they had had no ability to sell
19 milk to others, if Portland Independent had not had the
20 ability to sell milk to others at a price they thought was
21 profitable, it's possible, is it not, that they might have
22 made an arrangement with Sunshine Dairy to have the milk
23 bottled and sold even below cost, in bottle form, correct?
24 Certainly an option they had.

25 A. I'm not a milk marketing expert, but that would

1 seem a little suspect, in the fact that we're talking about
2 guaranteed blend prices. Wouldn't there be a blend price
3 that we're talking about needed to becoming to the market
4 administrator in that exchange?

5 Q. I don't think that's right, but you're asking me
6 a question that I'm supposed to ask you.

7 A. Okay. So then I'm going to decline that answer,
8 I'm not a marketing expert.

9 Q. Fair enough.

10 A. Okay.

11 Q. Well, since you're not aware of Sunshine's
12 marketing, how about Edaleen's marketing. When you lost
13 the Edaleen account with Starbuck's, did you put some of
14 that additional milk into the bottle and sell it at a
15 cheaper price, in order to handle that volume?

16 A. Yeah. We had to, at that point, time in our
17 business, pursue new customers, yes.

18 Q. Did you lower your price structure in order to
19 pursue those new customers?

20 A. I think that'd be proprietary.

21 Q. Fair enough.

22 Okay. You talked a minute ago about losing
23 Starbuck's business because of distribution. Let's make
24 sure the record's clear. Starbuck's has retail stores,
25 really throughout our region, do they not? Throughout the

1 Pacific Northwest marketing area.

2 A. In addition to the whole United States, yes.

3 Q. Yes, in addition to the whole United States.

4 And what section of the region were you -- have
5 you been servicing the Starbuck's stores, what was the
6 geographic area of your distribution to them?

7 A. Predominantly the Seattle metropolitan area,
8 western Washington.

9 Q. Including your area around Billingham.

10 A. Yes.

11 Q. North.

12 A. Yes.

13 Q. And as far south as what?

14 A. I think it was in Portland for a short time
15 period.

16 Q. And were you serving those stores directly or
17 with your own vehicles?

18 A. Through a distributor.

19 Q. The distributor had other accounts in that area
20 as well, did he not?

21 A. I don't know.

22 Q. The retail stores that we're talking about, the
23 Starbuck's operates, they post a price on the board for
24 each of their drinks, do they not?

25 A. Yes.

1 Q. Including their lattes, which have milk.

2 A. Correct.

3 Q. Would you agree with me that Starbucks doesn't
4 change that posted price anymore often than they have to?

5 A. I'm not -- I don't frequent their store often
6 enough to answer that question.

7 Q. Well, isn't it true that Starbucks came to
8 Edaleen in the first place because Edaleen could offer a
9 more stable price over a long term and thereby, avoid the
10 ups and downs of class one pricing that they would have if
11 they purchased from regulated bottlers?

12 A. That would've been one of the discussed items in
13 the marketing, that is not the only thing that was brought
14 up.

15 Q. Okay. Back to balancing. You testified
16 yesterday that there have been some times when you've had
17 difficulty disposing of surplus milk. Did I understand
18 that you actually had to dump milk at one point?

19 A. That is correct.

20 Q. I'm sorry about that.

21 A. That's all right.

22 Q. In that situation --

23 A. It's common to do in our business.

24 Q. Understood. In that situation, have you -- in a
25 situation where you've had surplus milk, did you ever sell

1 to regulated plants, regular bottling plants, excuse me?

2 A. Yes, we have.

3 Q. Have you ever sold to Matnesgamay Dairy in
4 Anchorage?

5 A. Yes, we have. Now, I understand that's not a
6 regulated plant that you're talking about.

7 Q. Right.

8 A. In the first previous question.

9 Q. Right. That's why I asked a separate question.

10 A. Okay.

11 Q. To whom, besides my organization, Northwest Dairy
12 Association and West Farm Foods, to whom have you sold
13 surplus milk?

14 A. I'm going to decline to answer that for one major
15 reason, is that the list I might provide is not -- I can't
16 possibly do the whole list, and I don't want to single
17 anybody out.

18 Q. Okay. Fair enough. Would it be fair to say that
19 there are multiple outlets that you found for surplus milk?

20 A. Describe multiple.

21 Q. I'll let you characterize it if you wish. I
22 mean, I don't know the names. I'm just trying to get to
23 the point that you do have those number of options.

24 A. The two previous ones, yourself and Matnesgamay,
25 they're the ones that come to mind, but I don't want to --

1 I'm under oath, so I don't want to lie to anybody, so I'm
2 going to decline for that fact. I can't promise you. I
3 don't know that we've ever sold to anybody else.

4 Q. Okay. Well, I respect you for that.

5 A. Okay.

6 Q. Now, you testified yesterday there's a time when
7 our organization was not able to take your milk, do you
8 recall whether you were told why at that time?

9 A. I did not have the personal phone call.

10 Q. Do you recall when that was?

11 A. It would've had to have been in my management
12 era, so within the last five years.

13 Q. Would it have been in the summer of the year?

14 A. I do not know.

15 Q. And were you told, ever told that there was a
16 time when we would not have the ability to take your milk
17 because all of our plants were full?

18 A. Like I said earlier, I was -- I did not place
19 that phone call.

20 Q. When you -- had we been able to take your milk at
21 that time, and I can represent to you that there are times
22 when we've had to move milk out of the Pacific Northwest to
23 Idaho because of lack of capacity, and assuming at times
24 when we can take your milk, you're using us to help balance
25 your milk supply, right?

1 A. Yeah.

2 Q. We were at the feedings hearing, and you might
3 have heard Garyl Generpol's (phon.) testimony, did you?

4 A. Yes.

5 Q. And he testified that he had a balancing contract
6 with Northwest Dairy Association and West Farm Foods. Your
7 organization and ours does not have such a contract.

8 A. No, we do not, which then would allow you the
9 opportunity to decline us.

10 Q. Pardon me?

11 A. Which then allows you the opportunity to decline
12 us.

13 Q. Right. Because we've never made a representation
14 to you that we would --

15 A. That is correct.

16 Q. -- always have a place for your surplus.

17 Are you aware that some of your neighbors in
18 Watkin County have very small cheese plants on their own
19 farm?

20 A. Yes.

21 Q. Have you ever considered doing that yourself as a
22 way to balance your own surplus?

23 A. I personally have not looked into that, no.

24 Q. It would be costly, would it not?

25 A. I assume any production line of any sort is

1 costly.

2 Q. Any production would be.

3 A. Any production -- processing, sorry. Any
4 processing line of any sort is expensive.

5 Q. I think you're saying, correct me if I'm wrong,
6 but I think you're saying that the investment in a
7 processing facility would be expensive.

8 A. Correct.

9 Q. But if you were to do that, then you would be
10 balancing your own milk supply with your own facility as
11 much as we have to invest in facilities to balance our milk
12 supply, right?

13 A. The answer's not clear in my head, so can you ask
14 the question again?

15 Q. Sure. I'm likening -- I'm asking if you agree
16 that if you were to build your own cheese plant, which
17 might be idle at times, invest in that capacity, you would
18 be doing balancing and making -- incurring balancing costs
19 much as we do by having standby clients for the pooled
20 producers and the pooled regulated handlers, similar,
21 right?

22 A. That would be an option, yes.

23 Q. And by not doing so, you are able to use your
24 plants available in the marketplace as described early to
25 balance your milk supply.

1 A. Those becoming optional, also. They're not a
2 guaranteed option.

3 Q. Right. For the most part, you've not had to dump
4 milk, you've been able to use other's facilities, right?

5 A. Correct.

6 Q. In that regard then, is your Edaleen Dairy
7 operation any different in terms of having to balance this
8 milk supply and incur costs to do so? Is it any different
9 -- is your challenge in balancing any different than the
10 challenge faced by Mr. Arbuthnot and Sunshine Dairy and
11 Portland Independent Dairy?

12 A. Yes.

13 Q. Portland Independent Cooperative.

14 A. Yes.

15 Q. And how is yours different?

16 A. We're all one company. In their situation,
17 there's two different companies. So we are the sole
18 responsibility of our over-production and our lost
19 customer. So we're getting hit with both ways. Where in
20 the Arbuthnot situation, they're dividing that amongst the
21 two corporations.

22 Q. Okay. Then let's not talk about them. Let's
23 talk about my organization. We're one organization of
24 producers who own plants, bottling plants like Mr.
25 Arbuthnot's, balancing plants like the one in Linden down

1 the road from your farm, we are one organization that would
2 have all those balancing costs, are we any different than
3 Edaleen Dairy in that respect?

4 A. I'm not comfortable enough with your coop to
5 answer that.

6 Q. Okay. It's -- are you aware that the producers
7 in Lufkin County have an investment in the plant there in
8 Linden and then the bottling plants in Seattle?

9 A. I'm aware they're part of a cooperative.

10 Q. Just as your farm has invested in a bottling
11 plant also.

12 A. Yes.

13 Q. So far no difference, right? Producers investing
14 in plants, no different. Any difference?

15 A. I am not familiar enough with the coop structure
16 to answer that.

17 Q. I'll represent to you that the producers or your
18 neighbors in Whatcom County are part of the owners of our
19 cooperative and the plants that we operate.

20 Now, assuming that, is there any difference
21 between them owning plants and you owning plants, in both
22 cases having to balance your own milk supply.

23 MR. UNIDENTIFIED: This is the same question
24 because he already represented to you and acknowledged that
25 they have an ownership interest (indiscernible). It's the

1 same question you just asked before.

2 THE COURT: Just try to rephrase again. You
3 know, let's give him one more try and otherwise, we'll just
4 have to move on.

5 THE WITNESS: I do not know your structure. I've
6 never been privileged in that information. I am very
7 uncomfortable answering that.

8 Q. (By Mr. Marshall) Fair enough, Rob. I'm not
9 trying to trap you and I just was -- structural issues
10 having to do with corporate entities and ownership, right?

11 Do you see it -- let me ask you the question this
12 way. Do you see a difference between your producer, family
13 farm operation, owning its own plant, versus a cooperative
14 of producers forming to acquire their own bottling plant?

15 A. You're still asking me to compare our farm to a
16 dairy cooperative.

17 Q. No, I'm asking in general about is there any
18 difference between --

19 A. In general, I --

20 Q. -- one producer electing to buy a bottling plant
21 versus a group of producers forming their own cooperative
22 to buy their own bottling plant.

23 A. You just said cooperative, I don't know how to
24 answer that question.

25 Q. Okay. Fair enough. You don't know and

1 therefore, you can't make a comparison.

2 Do you feel the federal order system provides
3 regulated handlers or pool producers any financial
4 incentive or financial reimbursement to cover the costs of
5 balancing the regulated market?

6 Would you like for me to rephrase the question?

7 A. Yeah.

8 Q. Does the pool -- does the mechanism of the
9 federal order give balancing plants that balance the
10 regulated market any financial advantage to operate a
11 balancing plant?

12 A. You're asking me whether the marketing order
13 gives you an advantage to balance among your own plants?

14 Q. Not an advantage. I'm asking if the federal
15 order in effect, the mechanism of the federal reimburses us
16 for balancing costs.

17 A. I don't know what the exchange of money is
18 between your plants and the market administrator.

19 Q. Do you feel the secretary when it establishes
20 regulations in the federal order should consider balancing
21 costs?

22 A. In our situation, I think they have.

23 Q. What if in our situation, they would not, would
24 you agree that they still should do so in your case?

25 A. Well, now you threw a couple of questions at me.

1 You put my company and your company in the same question.

2 Q. I'm sorry. You believe that the Secretary should
3 consider your balancing costs in analyzing issues in this
4 hearing, correct?

5 A. Absolutely.

6 Q. If it's true that they do not provide a balancing
7 reimbursement for our balancing costs, why should they
8 provide a balancing cost to you?

9 A. I don't know that that's true, so I can't answer
10 that.

11 Q. Fair enough.

12 I think I might be at the last question or series
13 of questions.

14 Compared -- I'm going to read a quote from Mr.
15 Van Dam's prepared testimony and ask if you can disagree
16 with this quotation.

17 Compared to a pooled producer of the same size,
18 producer part of a producer/handler operation has not one
19 penny of the extra costs just because the operation also
20 happens to own a operative plant.

21 A. I disagree.

22 Q. And referring specifically then to that
23 disagreement, what are the differences?

24 A. Well, the specific one that we talked about early
25 is the supply site.

1 Q. You mean, the balancing costs?

2 A. No, no, the supply to the processing plant. If
3 we're going to compare it to a shipper in Whatcom County, a
4 shipper in Whatcom County hauls for the hauling fee that we
5 talked about earlier, correct?

6 Q. Yes.

7 A. Okay. If my supply is not able to meet the
8 plant's needs, I will have additional trips and additional
9 hauling, supply costs to keep our plant in operation.

10 Q. Okay. I'm going to ask two questions. One about
11 the farm, one about the plant. As to the farm, what
12 additional costs do you have on the farm because of your
13 decision to remain qualified as a producer/handler?

14 A. Hauling costs.

15 Q. You have more hauling costs than a pool producer?

16 A. You asked me if they were the same. Correct?

17 Q. I'm asking you, in general, if you agree with the
18 statement that because you own a plant does not put you in
19 any different position as a farm enterprise, than your
20 neighbors who are operating dairy farms, and --

21 A. My response is yes.

22 Q. With respect to transportation?

23 A. That is one of them, yes.

24 Q. Is it your testimony that your neighbors don't
25 pay any hauling costs?

1 A. No. I am saying that my -- there are times when
2 my hauling costs would be greater than theirs, because they
3 would not incur the cost of keeping -- of additional
4 partial hauled loads to the plant to keep their operational
5 when my milk supply does not keep up with the plant.

6 Q. Well, is it your belief that all the farms in
7 Whatcom County ship full tanker loads?

8 A. I have no idea what that arrangement is, cost
9 wise. You're just asking if there's times where my cost
10 would be higher, and I think that would be one of them.

11 Q. But I think you earlier said you didn't think
12 that your total transportation costs were anywhere near the
13 40 cents that --

14 A. I never testified to that.

15 Q. I'm sorry, let's go back through it.

16 I represented to you that your neighbors in
17 Whatcom County have a hauling charge of roughly 40 cents, a
18 hundred weight based on volume.

19 A. You said that, yes.

20 Q. And I asked you if your costs were that high.
21 And are they that high?

22 A. I remember you asking the question of the 40
23 cents. I don't recall saying that ours was 40 cents.

24 Q. No, I don't believe you did say that.

25 A. Okay.

1 Q. You said you didn't know what your hauling costs
2 were.

3 A. That's what I'm drawing a blank here, why I
4 would've said yes that ours would be similar to the 40
5 cents.

6 Q. And that was earlier in your testimony that you
7 said you didn't know --

8 A. Right.

9 Q. -- and a moment ago when I asked you whether you
10 had any special costs because of -- on your farm, because
11 of your status, choosing to retain your status a federal
12 order exempt --

13 A. Correct.

14 Q. -- producer/handler, you said hauling costs were
15 low. Why do you believe that?

16 A. For the reason I explained earlier, the
17 additional trips.

18 Q. So you believe your farm costs for transportation
19 are higher than what regulated pool producers have?

20 A. That's your assumption.

21 Q. Then straighten out my confusion.

22 A. Well, I'm -- yeah.

23 Q. All right. Any other reasons why your farm, as a
24 farm operation, has higher costs, because you elect to
25 retain your status as an exempt producer/handler?

1 A. At this point, I'm going to decline to answer
2 that.

3 Q. Okay. Fair enough. On the plant side, do you
4 believe there are any costs that you incur -- what are the
5 costs that you believe you incur because of your decision
6 to remain an exempt producer/handler plant that are not
7 incurred by regulated plants?

8 A. I am not prepared to answer these questions,
9 other than the obvious ones that we had talked about
10 earlier with supply management and such, to go into much
11 more detail in the plant.

12 Q. Fair enough. But I believe you testified
13 yesterday to Mr. Yale's questions that if you would become
14 a regulated (indiscernible) would cost you a lot of money,
15 right?

16 A. That is correct.

17 Q. Is there any way you can compare for us, for the
18 Secretary, the additional costs that you face either as a
19 producer farm or as a plant with the additional cost of
20 regulation? In other words, do the cost that you described
21 as additional costs not faced by your competitor producers
22 or your competitor plants.

23 A. I would be asked to pay close to a million
24 dollars into the producer fund, and I don't have that kind
25 of money in the bottom line to put into that. So that is -

1 - if I were to become regulated, I'd have to come up with a
2 million dollars.

3 Q. Okay. So that's the basis for your concern. Are
4 you arguing that -- in addition to that, are you arguing
5 that the additional costs, the million a year that you
6 described, --

7 A. Correct.

8 Q. -- is out-weighed or balanced against the
9 additional costs that you have operating as a
10 producer/handler under the restrictions of that exemption?

11 A. Are you asking me that whether I can answer that
12 I'm spending a million dollars on supply management?

13 Q. Or other factors that are unique to your status
14 as a producer/handler?

15 A. I cannot answer that, but I've not ran a
16 regulated plant to know what those costs are compared to
17 mine. I know that I'm incurring costs, and that if I were
18 to become regulated, that that million dollars is a lot of
19 money that I would not know -- we would have to change our
20 business to come up with that money. We could not operate
21 the way we are.

22 Q. Which might put you back where your neighbors
23 are, right?

24 A. That would be -- explain my neighbors.

25 Q. Well, many of your neighbors are not able to

1 operate where they are either, right?

2 A. There are some that are successful and expanding
3 right now. I mean, they're not all out of business. That
4 would be an option that we'd have to look at to be a
5 producer, if one option is going to become a regulated
6 handler. But the concept of us operating as we are today,
7 being regulated, is not -- something would have to change.

8 Q. Okay. Fair enough. Thank you so much for your
9 help.

10 THE COURT: Anymore questions from the
11 proponents' side? Mr. Rower, do you have any questions?

12 MR. ROWER: I think Mr. Cherry had some
13 questions.

14 MR. CHERRY: Richard Cherry, USDA.

15 EXAMINATION

16 BY MR. CHERRY:

17 Q. Good morning, sir.

18 A. Good morning.

19 Q. I had two questions for you. First question was,
20 how many employees do Edaleen currently have?

21 (tape change.)

22 Q. -- this proposal is implemented, what type of
23 impact would it have on your small business, besides the
24 additional million dollars producers settlement fund.

25 A. The financial would be a big one. The other --

1 the impacts would be jobs, are the ones that if we would
2 have to change our business depending what department
3 happens, you know, you're looking at the jobs of these
4 people.

5 MR. CHERRY: Thank you.

6 MS. DESKINS: Charlene Deskins, United States
7 Department of Agriculture, also General Counsel. I had a
8 couple of questions for you.

9 EXAMINATION

10 BY MS. DESKINS:

11 Q. You had testified earlier that there's some
12 environmental limits, which you said effect the size that
13 your organization can be.

14 A. That is correct.

15 Q. In your opinion, would that apply to other
16 producer/handlers within the marketing order?

17 A. In the State of Washington, I can say, yeah, that
18 is true.

19 Q. Do you think these environmental -- how big do
20 you think these environmental factors would allow a
21 producer/handler to become?

22 A. The environmental issues are based on the land
23 and the cows waste stream onto that land. So if a
24 producer/handler would want to grow, it would have to
25 purchase additional land in addition to the facilities and

1 the cattle and the processing, so that to grow, is a huge
2 financial investment to make that happen.

3 Q. And do you think that a financial investment is
4 enough to keep a producer/handler at a certain size?

5 A. It prohibits rapid growth.

6 Q. Okay. Do you think there's any other factors
7 besides environmental, that would keep producer/handlers at
8 a certain size?

9 A. The balloting of your customer at the production,
10 if you are inexperienced, now having a customer become too
11 large, you know, with the box stores and stuff becomes a
12 big risk. The risk involved with growing is a big risk.

13 Now, at some times you have situations where we
14 did have a commitment and lost it later. But, you know,
15 there will be opportunities to grow. So, I mean, it'll
16 become a business environment, you know, as the
17 opportunities arise and don't arise, it's a risk management
18 decision.

19 Q. Okay. So when you say the customer becomes too
20 big, --

21 A. Uh-huh.

22 Q. -- are you saying then that the size of the
23 customer can limit how much -- what -- who the
24 producer/handler can service?

25 A. Yeah. In the fact that if that customer were to

1 leave, the over-production will be such a large number,
2 that it would financially take you down.

3 Q. Okay. And also, do you consider your dairy as
4 serving a unique segment of the market or a niche area of
5 the market?

6 A. Unique in the fact that we service, in addition
7 to the distributors that we supply, and ourselves, are
8 willing to stop at a lot of the smaller gas stations, the
9 espresso stands that I talked about last week, which
10 additional stops more than a once a week large semi-truck
11 stop. And our willingness to do that, has allowed us to
12 keep those customers.

13 Q. Okay. And also, if -- let's say a
14 producer/handler is serving a unique segment of the market,
15 or a niche area that otherwise wouldn't be serviced, if a
16 producer/handler servicing that area, should a limit be
17 placed on their size?

18 A. No. Because, for example, in the 1980s espressos
19 was kind of unheard of in this area, you know, and then
20 Starbuck's brought them in, and that whole niche market
21 kind of exploded in the '90s. Had I had a limit before
22 that, I would've never been able to pursue that market.

23 Q. Okay. Also, you as a producer/handler you
24 compete with other producer/handlers, I assume?

25 A. That is correct.

1 Q. And also other handlers for customers.

2 A. That is correct.

3 Q. If the handler were to become so big that they
4 were to dominate the market by say handling over 50
5 percent, would you support the handler being some sort of
6 limit on the size of the handler?

7 A. I feel that the market order right now as it is,
8 gives a situation where we can co-exist. Now, if a handler
9 gets that large, that would be something that the Secretary
10 would have to look at. At this point, we get customers
11 from the regulated handlers, the regulated handlers get
12 them from us. It seems to be a market place where we co-
13 exist and have for quite a long time.

14 Q. Also, you compete with other producer/handlers.

15 A. Yes, we do.

16 Q. What happens if another producer/handler became
17 so big that they dominated the market, they were over 50
18 percent of the market? Do you think at that point some
19 regulation should be put in?

20 A. No. Nothing different than what is in place
21 today.

22 MS. DESKINS: Thank you.

23 THE COURT: Mr. Beshore.

24 MR. BESHORE: Marvin Beshore for Dairy Farmers of
25 America, Mr. Heerspink.

EXAMINATION

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BY MR. BESHORE:

Q. When's the last time that Edaleen Dairy has ever had -- has had to dump or dispose of good milk because it was contaminated with antibiotic milk?

A. It has been a while, so I mean, I'm not going to be able to give you an exact date. More than five years ago.

Q. Not during your management?

A. Correct.

Q. In other words. Okay. And some time more than five years ago.

A. Correct.

Q. Have you ever used the ability purchase 150,000 pounds from pool sources to meet any emergency supply situations?

A. Yes, we have.

Q. How often have you used that?

A. Not very often. The -- we have only been able to locate one supply that is a long ways away to get it, so it is extremely cost prohibitive to do.

Q. Okay. Is Edaleen Dairies a -- you may have answered this and I'm sorry if I ask it again, but are you a partnership, a corporation, or what kind of legal structure?

1 A. We're a limited liability company.

2 Q. Now, are all of the assets of the farm and plant
3 owned by the LLC?

4 A. Yes, they are.

5 Q. Now, if -- you've said that regulation, full
6 regulation would mean close to a million dollars in pool
7 equalization payments that you don't have now, correct?

8 A. That is correct.

9 Q. Okay. And if you get new expenses like that,
10 you'd have to figure out to deal with them.

11 A. Absolutely.

12 Q. Okay. And increasing the top lines, one of the
13 strategies that you could look at, increase your prices.

14 A. What do you mean?

15 Q. Increase your prices. Prices for your --

16 A. If the market would bear it, yeah.

17 Q. Okay.

18 A. But at this point, with the exchange of customers
19 that's happening, I wouldn't count on that being a likely
20 option.

21 Q. Okay. So you're already charging all the market
22 will bear for all of your products in competition with the
23 regulated handlers.

24 A. I'd lose customers if that's what you're
25 referring to.

1 MR. BESHORE: Okay. Thank you.

2 THE COURT: Go ahead.

3 MR. ENGLISH: Sir Charles English for Dean Foods
4 and Chandler Foods.

5 EXAMINATION

6 BY MR. ENGLISH:

7 Q. Now, I'm the one who's confused. Do you
8 understand these proposals, if adopted, --

9 A. Uh-huh.

10 Q. -- to actually limit the size of your plant?

11 A. No.

12 Q. Thank you.

13 MR. MARSHALL: Doug Marshall again, Mr.
14 Heerspink.

15 EXAMINATION

16 BY MR. MARSHALL:

17 Q. Following-up on the questions that Mr. -- that
18 Ms. Deskins asked you, excuse me, Charlene, about
19 limitations on growth of a producer/handler such as the
20 environmental issues and I think you responded about the
21 inability to serve large accounts.

22 Are those limitations ones that you could
23 overcome if you had enough capital? If you had unlimited
24 access to money.

25 A. If Bill Gates showed up and give me a bunch of

1 money?

2 Q. Yeah.

3 A. Yeah, I could build another farm, yeah.

4 Q. You and Bill could buy up all the farms in
5 Whatcom County.

6 A. There you go.

7 Q. And you could build the biggest 50 million pound
8 plant or whatever that a fellow yesterday was saying that
9 you needed to have to be efficient, right?

10 A. I don't know if that customer exists.

11 Q. All right. But my point is, it's a matter of
12 scale, is it not, and capital that limits you, not the
13 environmental regulations or the marketplace.

14 A. Let's break it apart.

15 Q. Sure. Are there any problems that you're
16 describing as natural limitations on a producer/handler's
17 growth that couldn't be overcome if you and Bill Gates, is
18 a good hypothetical, were to go into partnership?

19 A. Yes, I could buy another cow, another barn,
20 another acre with capital to expand. And I would have to
21 put improvements to the plant.

22 Q. Or build a new one.

23 A. Or build a new one, yeah.

24 Q. If you had the capital, you could service
25 virtually any customer base that's out there, in terms of

1 your capacity, right?

2 A. Yes, but I would also be increasing my risk.

3 Q. No, Bill's risk.

4 A. Well, Bill's risk, yeah.

5 Q. Agreed. Okay. Now, how and given that you do
6 face -- Bill hasn't showed up, right?

7 A. No.

8 Q. So given that you do face those capital
9 constraints, is your situation really any different than
10 owners of Vitamilk Dairy (phon.) face?

11 A. Yes, in the fact that Vitamilk did not have a
12 dairy farm, in addition to the capital they had in their
13 processing facility.

14 Q. So they had less money invested, didn't they, in
15 the combination of farm and plant than you do, I would
16 guess than you do. Would you agree with me?

17 A. I don't know how much money they had invested.

18 Q. Would it not be fair to say that if Vitamilk
19 Dairy had had unlimited access to capital, they could have
20 expanded their market and serviced any account of any size?

21 A. If the customer was there, yeah.

22 Q. Pardon me?

23 A. If there was a customer that existed that would
24 do that, I mean, anybody could, you could also.

25 Q. So is this about producer/handler status, or is

1 this about economic scale?

2 A. Economic -- well, it's about a lot of things.

3 Q. Is there any difference in that regard between
4 regulated handlers and producer handlers?

5 A. Yes.

6 Q. What would that be?

7 A. The fact that I should have the sole
8 responsibility and in being asked to pay a million dollars
9 into the producer fund, that I know I cannot do. And
10 operate the way I do today.

11 Q. Okay. Fair enough. Thanks.

12 THE COURT: Mr. Ricciardi, do you have some
13 questions?

14 MR. RICCIARDI: Al Ricciardi for Sarah Farms
15 (phon.).

16 EXAMINATION

17 BY MR. RICCIARDI:

18 Q. Rob, good morning.

19 A. Good morning.

20 Q. I've been listening to a lot of these questions,
21 and most of them are phrased in terms of hypothetical or
22 assumptions, et cetera, et cetera. I'm going to ask you
23 about the real world.

24 A. Thank you.

25 Q. In the real world, you work on the producer side

1 of the Edaleen Farm, right?

2 A. That is correct.

3 Q. How many hours do you work?

4 A. A day?

5 Q. Yes, sir.

6 A. Approximately 12.

7 Q. Okay. So as Mr. Hannicut (phon.) tells me, you
8 only work a half a day?

9 A. There you go. I got the other half to myself.

10 Q. Good deal. And that much time is required in
11 order for you to be able to operate the farm portion of
12 Edaleen the guys you want to operate it as a family,
13 correct?

14 A. That's correct.

15 Q. This million dollars that they want to take away
16 from you, --

17 A. Yes.

18 Q. -- did they earn it?

19 A. I don't think so.

20 Q. Did they do anything for you?

21 A. No, they did not.

22 Q. If you have to account for a million dollars,
23 would you have to potentially cut employees?

24 A. Yes, I would.

25 Q. Would those individuals lose their jobs?

1 A. Yes, they would.

2 Q. Would families in the area that you employ them
3 therefore have people who were the principle bread winners
4 lose their jobs?

5 A. Absolutely.

6 Q. I assume that you have not -- the dairy portion
7 of your business hasn't made the dairy 100.

8 A. No, they have not.

9 Q. Like Safeway has.

10 A. No, they have not.

11 Q. You don't have, on the processing side, 17
12 plants, do you?

13 A. No, we only have one.

14 Q. You don't sell close to a billion dollars in
15 dairy products?

16 A. No, we do not.

17 Q. And let's talk about that. Is it an unfair
18 advantage for Safeway to have stores?

19 A. I think that is a business decision that they
20 have made, and it falls within the regulations, so if
21 they're playing by the laws, I don't know. I can't say
22 it's unfair, it's to their advantage.

23 Q. Okay. And let's face it, there are advantages
24 and unfair advantages to certain things. I mean, certain
25 people may decide even though it's really an advantage for

1 them if they're a golfer to use the newest technology, they
2 may like wooden shafted clubs, right?

3 A. That's correct.

4 Q. And to them, it may be an advantage.

5 A. That's correct.

6 Q. It's not unfair or fair, right?

7 A. That's correct.

8 Q. With regard to Safeway, they made a decision to
9 expend capital or the capital of others in building a bunch
10 of plants.

11 A. That is correct.

12 Q. And having stores.

13 A. That is correct.

14 Q. They took away from you the Starbuck's account,
15 correct?

16 A. Yes, they did.

17 Q. You have to assume when they took that away from
18 you, getting back to this side of the room, we'll make an
19 assumption for a second, that they were attempting to sell
20 at a price where they would make money?

21 A. I would assume that they're going to make their
22 contract with selling milk that they would be covering
23 their costs and making a profit.

24 Q. But you were told by Starbuck's essentially that
25 you had to match that price and you couldn't.

1 A. That is correct.

2 Q. So somehow they had some kind of an advantage
3 over you to be able to sell at the price that you couldn't
4 sell at.

5 A. That is correct.

6 Q. And we assume that they're regulated.

7 A. Yes, they are.

8 Q. I guess I don't understand. If you have this
9 unfair price advantage, how you weren't able to make the
10 price and keep that Starbuck's business. I guess we'll
11 have to figure that out. Thanks.

12 THE COURT: Mr. Marshall, ask another question
13 and then we'll --

14 EXAMINATION

15 BY MR. MARSHALL:

16 Q. One quick question. Doug Marshall, Northwest
17 Dairy Association.

18 With respect to the comparisons between you and
19 the Safeway bottling operation, is it not true that
20 Sunshine Dairy in Portland or any other small regulated
21 handlers are in exactly the same situation that you were
22 in?

23 MR. UNIDENTIFIED: Object to the form, no
24 foundation.

25 THE COURT: I'll let him answer it if he knows

1 the answer.

2 THE WITNESS: I don't.

3 MR. MARSHALL: Thank you.

4 THE COURT: Mr. Yale, any redirect?

5 MR. YALE: (Inaudible.)

6 Ben Yale on behalf of Smith Brothers Dairy,
7 Edaleen Dairy and Mallory's Dairy.

8 STATEMENT

9 BY MR. YALE:

10 Q. Good morning, Rob.

11 A. Good morning.

12 Q. I mean, we've seen the last hour and a half or
13 so, it's probably a good thing we did take a break.

14 A. Yeah.

15 Q. There have been some talk and some of these
16 questions dealing with investment and comparing the
17 investment to Edaleen or the families that own Edaleen
18 Dairy have with theirs and farmers or coops that have
19 investment in coop and like. I want to kind of address
20 that distinction.

21 First of all, the investment that you and your
22 wife have, you have an investment in Edaleen, right?

23 A. Yes, we do.

24 Q. Now, are your investments diversified in any way
25 outside of Edaleen?

1 A. No, they're not.

2 Q. Do you know whether or not the other family
3 members that owned Edaleen are diversified?

4 A. No, they are not.

5 Q. And how many generations and investments are tied
6 into this operation?

7 A. I would be the fourth.

8 Q. You'd be the fourth generation.

9 A. Yeah.

10 Q. Now, when we -- are you familiar -- I think you
11 mentioned something last night that your family was a
12 member of a coop or something years ago.

13 A. When I grew up, yes.

14 Q. And they had a capital investment in the coop.
15 You don't --

16 A. Yeah, I was a kid.

17 Q. And did you have any understanding that they or
18 any of your neighbors that are farmers in Whatcom County
19 that their whole investment lies in their ownership in the
20 coop?

21 A. No, I don't know that.

22 Q. You don't know either way?

23 A. No.

24 Q. Now, there was some talk of some alternatives to
25 adding production to meet demand. I think Mr. Marshall

1 asked you questions of leasing cows and buying old
2 facilities and the like.

3 A. Right.

4 Q. I want to come back to this question. If today,
5 Edaleen had an opportunity to add say, ten percent to its
6 sales, --

7 A. Okay.

8 Q. -- and needed the production to do that.

9 A. Okay.

10 Q. Okay. Does it have the ability to immediately
11 add ten percent production or -- ten percent supply of its
12 milk?

13 A. I do not.

14 Q. And how long, even under the scenario of finding
15 another existing farm and getting it fixed up to meet your
16 standards and get cattle in there, how long would that
17 take?

18 A. I mean, we're talking super fast line and finding
19 what Doug was assuming was out there. I mean, you're
20 looking at 30 days to go -- yeah, 30 days, I don't think
21 that could even be done. It's not tomorrow, that's for
22 sure.

23 Q. And assuming that they have an environmental
24 program, right?

25 A. That's correct. There's a lot of stuff to go

1 through.

2 Q. Now, other than Starbuck's, are you aware of any
3 other customer that gave you 30 days to bring up that
4 supply?

5 A. No. The customer would be gone if I didn't, by
6 the time I'd be able to rev up the production that much.

7 Q. Now, you kind of shared some chagrin last night
8 over the dumping of milk. Let's talk about your herd.

9 Do you, as a herdsman, establish a relationship
10 with your animals, in terms of caring for them?

11 A. Certainly.

12 Q. And is there a sense of loss when you lose one?

13 A. Yeah.

14 Q. Let's take a situation where due to the downturn
15 of sales from Edaleen.

16 A. Okay.

17 Q. At the plant.

18 A. Okay.

19 Q. That effects the production, right? I mean, your
20 farm production, right? I mean, you're going to have too
21 much milk.

22 A. Yeah, I will have too much milk, yes.

23 Q. Okay. So you can dump for a while or sell for a
24 while, but there comes a point where that's not
25 economically viable, right?

1 A. That is correct.

2 Q. So if it turns out that you have to downsize the
3 farm, --

4 A. Yes.

5 Q. -- what would you have to do?

6 A. I would have to sell some cattle.

7 Q. What about employees?

8 A. They would be laid off.

9 Q. And what about the remaining capital that you
10 have invested in that farm?

11 A. It would still need a payment at the end of the
12 month.

13 Q. So you become less efficient?

14 A. Absolutely.

15 Q. And really not be able to easily make a down-size
16 on your whole operation?

17 A. No.

18 Q. Did Vitamilk have that situation when they had to
19 downsize?

20 A. Not with the cattle, no.

21 Q. I want to follow-up on a question I think by Ms.
22 Deskins about the land and the environmental issues.

23 A. Uh-huh.

24 Q. I think you stated that to acquire an additional
25 herd, you have to have land to --

1 A. Yes.

2 Q. And what is the -- and based on the soil types in
3 that part of the country and the like, what is the general
4 rule of thumb on number of acres per mature cow?

5 A. Two cows per one acre.

6 Q. Okay. So if you added 500 cows, you'd need 250
7 acres.

8 A. That is correct.

9 Q. And that acreage has to be in proximity to the
10 farm or the --

11 A. Yes, otherwise, you would not be able to get the
12 waste to the land, which is the reason for the land, in
13 addition to, yeah.

14 Q. Now, cows, you know, if you needed 500 cows
15 today, you could probably round up 500 cows, right, fairly
16 quickly?

17 A. You'd have to go to the marketplace.

18 Q. But within a week or two, do you think you could?

19 A. I would suspect that, yeah. I mean, through -- I
20 don't know of 500 cows for sale right now, but I would --
21 yeah, you would go out and pursue 500 cows to buy.

22 Q. And -- well, what about land? What's the
23 availability of land?

24 A. It's limited because they're -- like Mr. Marshall
25 brought up, there is a lot of dairymen in our area that

1 have the same environmental requirements, and also there is
2 a thriving raspberry industry in our area that is competing
3 for the land.

4 Q. And when you talk about raspberry, you cannot use
5 the manure to fertilize raspberries, right?

6 A. No, we cannot, no. There are times even if you
7 did have the capital, there is just no land available to
8 rent and/or buy.

9 Q. Also, I think there's a question to Ms. Deskins,
10 she talked about the niche and I think you responded that
11 you got a lot of small coffee shops and convenience stores
12 and stuff that you service, right?

13 A. That is correct.

14 Q. Now, are these customers that have been -- let me
15 rephrase that.

16 Do you know if there are regulated handlers that
17 are regularly trying to service those customers today, some
18 of the small ones?

19 A. Not that I'm personally aware of. I mean, well,
20 I don't know how to answer that one. That's not my
21 expertise.

22 Q. Okay. Are you aware of whether or not some of
23 the major bottlers and regulated handlers in this market
24 have made a business decision not to service small
25 customers?

1 A. Yes, I am aware of that, that they have chosen
2 not to go after that sized distributed -- having those
3 smaller sales.

4 Q. Are most of these corner coffee shops and other
5 stores and stuff, are these owned by big corporations?

6 A. No, they are not.

7 Q. They tend to be small mom and pop as we say?

8 A. Yes.

9 Q. So those are small businesses, right?

10 A. Absolutely.

11 Q. And if you were unable to function -- continue to
12 function as a processor at Edaleen Dairy, would they --
13 would there be a potential impact on them?

14 A. Yeah. Their supply of milk -- they would have
15 less options for milk and thus, probably the price going up
16 and/or they would have to expand their facilities to handle
17 large deliveries.

18 Q. The -- there's been this discussion and testimony
19 yesterday or even, yeah, in the last couple of days at
20 least, the questions related to, I think you called this
21 grass to glass. What do we mean grass to glass?

22 A. We have inter-company -- have the ability to know
23 where that cow is, where the milk supply came with, what
24 the inputs to those cattle were, how the milk was handled,
25 delivered, processed and delivered to the store.

1 Q. Now, I think -- I'm not sure Mr. Marshall
2 directly asked it this way, I thought he did, but I know
3 yesterday the question came, and I wanted to direct you to
4 it.

5 And that was, he did ask you, I think that this
6 was a business strategy.

7 A. Yes.

8 Q. All right. And I think he asked the question
9 that that's not required to be a PD, right?

10 A. No, that is correct.

11 Q. All right. But take the situation, I think you
12 mentioned this million dollars, if you have to, in the
13 operation of this grass to glass --

14 A. Uh-huh.

15 Q. -- have to spend a million dollars, will you be
16 able to maintain the grass to glass operation?

17 A. If I become regulated?

18 Q. Yes.

19 A. No, I would not. I have no way of coming up with
20 that money and keep that principal.

21 Q. So something would have to change.

22 A. Absolutely.

23 MR. YALE: I don't have any other questions.

24 THE COURT: Okay. The witness may step down.

25 Thank you very much for your testimony. We'll take a

1 break. Let me ask who your next witness is going to be,
2 Mr. Yale.

3 MR. YALE: Mr. Pete Ellis.

4 THE COURT: Okay. So we'll take a --

5 MR. UNIDENTIFIED: I thought Dr. Knutson (phon.)
6 was going to be the witness for today, and he's here.

7 THE COURT: My list has Nolan Knutson
8 consecutively.

9 MR. YALE: We always said from the beginning
10 (indiscernible) carry over.

11 THE COURT: I mean, that's the list that they
12 gave me and it's the one I read yesterday. So we'll take -
13 - we'll come back at about 20 after the hour. Just under a
14 15 minute break.

15 (A break was held.)

16 THE COURT: Okay. Now, we are back on the
17 record. And, Mr. Yale, are you going to call your next
18 witness?

19 MR. YALE: Ms. Reed's going to do it.

20 THE COURT: Okay. Ms. Reed.

21 MS. REED: Thank you, Your Honor. I call Pete
22 Ellis.

23 THE COURT: Okay. Mr. Ellis, I'll ask you to
24 raise your right hand.

25 PETE ELLIS, WITNESS, SWORN

1 THE COURT: I need you to please state and then
2 spell your name.

3 THE WITNESS: Pete Ellis, E-l-l-i-s.

4 MR. UNIDENTIFIED: I'm sorry?

5 THE WITNESS: Pete Ellis.

6 EXAMINATION

7 BY MS. REED:

8 Q. Good morning again, Pete.

9 A. Good morning.

10 Q. I just want to talk with you a little bit about
11 today and there is no prepared statement, so folks know
12 that.

13 What do you do for a living, Pete?

14 A. I'm the milkman. I'm a home delivery milkman.

15 Q. And do you own your own business?

16 A. Yes.

17 Q. Okay. And do you have a contract with somebody?
18 Who do you work -- who supplies your business?

19 A. Smith Brothers.

20 Q. Okay. Have you had a long-term relationship with
21 Smith Brothers Farms?

22 A. Yes, I have.

23 Q. Can you tell me a little bit about that?

24 A. I started on the farm crew back in the late '60s
25 and worked my way through the farm crew onto the plant for

1 a short time, when milk got opened up, and then I went
2 independent on the milk route, home delivery.

3 Q. So how long have you been running your milk
4 route?

5 A. 26 to 27 years.

6 Q. Okay. So you're not an employee of Smith
7 Brothers Farms; is that right?

8 A. That's correct.

9 Q. Okay. Are there others like you that have a
10 relationship, similar set-up, business set-up with Smith
11 Brothers Farms?

12 A. Yeah, I think there's about 60 of us.

13 Q. About 60. Can you tell me a little bit about
14 your customer base?

15 A. I survive basically on the small stuff that no
16 other areas want to serve. We cater to home delivery,
17 small espressos, daycares.

18 Q. And approximately -- and I'm sure there's some
19 variation, but approximately how many customers do you have
20 on your home delivery route?

21 A. 8 to 900, maybe 1,000.

22 Q. Since you've been running that route, 26, 27
23 years, I would assume that you've had some long time
24 customers; is that right?

25 A. Yes, that's for sure.

1 Q. And are you now seeing the second generation of
2 some of those families?

3 A. I hate to admit that, but, yeah, I am, more and
4 more.

5 Q. Okay. What do your customers like? First, let's
6 talk a little bit and I'll ask you more about the milk and
7 the products they purchase from you, but what do you think
8 it is about your relationship, or what can you provide to
9 your customers that has allowed you to keep customers from
10 now into a second generation?

11 A. Quality of the product, service, and people enjoy
12 having the milkman. It's kind of nostalgic. We're about
13 the only show on the road left like that anymore, and
14 people really enjoy that.

15 Q. Okay. Tell me a little bit about the day-to-day
16 operation of your business and kind of what your day is
17 like.

18 A. We park our trucks at the dairy, which is very
19 fortunate and convenient, and then -- so I pick my truck up
20 in the morning and then I have my home retail routes
21 developed and about five days a week.

22 Q. And that's Monday through Friday?

23 A. Yes.

24 Q. What time do you usually arrive at the dairy or
25 what's your schedule like during the day?

1 A. I get to the dairy between 5:00 and 5:30, and I
2 usually get back to the dairy anywhere between 4:00 and
3 5:00 o'clock that evening.

4 Q. Do you have any employees?

5 A. I have one employee, yes.

6 Q. Okay. And do you do -- since you are your own --
7 running your own business, do you then do all your
8 bookkeeping and things like that yourself?

9 A. Yeah. It's totally up to us to sign for all
10 customers, to bill them, to collect, phone calls, yeah,
11 everything's up to us.

12 Q. So all of that work goes on in addition to
13 actually running your route?

14 A. Yeah.

15 Q. And you run your own route?

16 A. Yes, I do, yes.

17 Q. What kinds of products do you offer to your home
18 delivery customers?

19 A. The variety of milk, you know, whole milk, two
20 percent, one percent, aphadolphis (phon.), orange juice,
21 apple juice, cookie dough, coffee beans, butter, eggs,
22 yogurt, chocolate milk.

23 Q. Staple-type products?

24 A. Right.

25 Q. And how often -- for your home delivery

1 customers, how often do you typically visit their homes?

2 A. Once to twice a week.

3 Q. Once or twice a week. And how do they -- are
4 there times when your customers aren't home when you're --
5 and you're still able to make deliveries?

6 A. Yes. I supply them with an insulated porch box,
7 or I also offer the service that I can go into their house
8 and when they're not home, I have keys, or go to the garage
9 and I put the milk away in the refrigerator for them.

10 Q. And I imagine that this is a convenience that
11 your customers really enjoy?

12 A. Yeah, I think so. They say they do. I try to
13 make it enjoyable.

14 Q. What particularly do they tell you about the
15 dairy products that you supply from Smith Brothers Farms
16 that they have come to expect and enjoy?

17 A. It's really important that they're familiar with
18 our dairy, because we're locally owned. We've been family
19 owned, you know, since 1920. And they know that we don't
20 have any of the artificial growth hormones in our milk, and
21 that's really important to them when they're giving it to
22 their families and kids.

23 Q. Do you feel like you're able to offer them a very
24 fresh product as well?

25 A. Oh, yeah, a lot fresher.

1 Q. And that's something that your customers have
2 grown to expect as well?

3 A. Yes. I try to tell them it's sometimes under 24
4 hours from the time it leaves the cow to the time it's on
5 their doorstep.

6 Q. You said that you are responsible yourself then
7 for invoicing your clients and doing the collections and
8 things associated with that. Now, if your clients aren't
9 home, how do you know what to delivery, what type of
10 relationship do you have set up for that type of thing?

11 A. Usually when I sign a customer up, they'll set up
12 a standing order. They'll tell me how many gallons of milk
13 they want each week or each time, and that's their standing
14 order, and then I just leave them a list of the products
15 that we have, and they'll leave me a note in the box or on
16 the refrigerator what they want, in addition to that milk
17 that day.

18 Q. Okay. So even though they might not be home,
19 they're able to let you know if they want to change that
20 week?

21 A. Uh-huh, yes.

22 Q. And how do you handle payment then of your
23 accounts? Not from Smith Brothers, but from your
24 customers?

25 A. I bill them once a month. They get a once a

1 month statement.

2 Q. Okay. And then are they able to mail payments or
3 leave payments at the home, or how does that work?

4 A. They both -- they leave it in the box, or they'll
5 mail it in.

6 Q. Okay. And then from the Smith Brothers' side,
7 how do you account for the products that you receive?

8 A. They give me a statement every two weeks.

9 Q. Okay. Who asked you to testify today?

10 A. Alexis.

11 Q. And you're referring to Alexis Castro of Smith
12 Brothers Farms?

13 A. Yes, I am.

14 Q. And are you aware that Smith Brothers Farms is a
15 producer/handler?

16 A. Yes, I am.

17 Q. And, in your mind, what does that mean to you?

18 A. That we use our own milk and bottle it. And, you
19 know, that's what I tell my customers that we know what our
20 cows get, and more importantly, we know what our cows don't
21 get, and that's a big selling factor for my customers.

22 Q. And that's something that you're proud to offer
23 your customers, right?

24 A. Absolutely, yes.

25 Q. And do you think that most of your customers see

1 that as a reason to continue buying products from you?

2 A. Yes, I do.

3 Q. Now, you're familiar with the competitive market
4 in this area, at least at some level; is that right?

5 A. Yes.

6 Q. And other than Smith Brothers, being a supplier
7 is there anyone else that you're aware of that could --
8 that would be willing to and could supply your needs and
9 the needs of your customers the way that Smith Brothers can
10 do?

11 A. No, I really don't think there is.

12 Q. Can you give me an example of why that is, or
13 what's so unique that Smith Brothers can offer you that you
14 can then pass on to your customers?

15 A. They kind of established a system where we have
16 down there that -- well, to start off at the beginning,
17 it's very convenient that we can park our trucks, we can
18 leave our trucks right there. They give us a small office
19 space to work in down there, which is very convenient.

20 Q. At that plant location you're talking about?

21 A. Yes. And then it's very convenient the fact that
22 we can order -- we change our order at the last minute, I
23 can return product that I didn't need. I can order small
24 quantities of things. For example, I have a customer that
25 takes eight half pints once a week. I'm able to order

1 those eight half pints. And this week, they were on
2 vacation and they left a note saying they didn't need those
3 eight half pints. So I was able to return those, and I'm
4 not aware of any other dairy that probably would allow us
5 to do that.

6 Q. Even as far as just buying eight half pints of a
7 particular product.

8 A. Yeah, right.

9 Q. So I think that what you're saying is that the
10 flexibility, --

11 A. Yes.

12 Q. -- there's a flexibility throughout the line that
13 allows you to pass that along to your customers then as
14 well.

15 A. Yes.

16 Q. Do you enjoy working for Smith Brothers or
17 working, you know, I know you're not an employee, but
18 working with that company.

19 A. Yes, I am very proud to do that, yes.

20 Q. You mentioned when we first started talking, that
21 you considered yourself a small business, that you run your
22 route and that you also have one employee.

23 A. Yes.

24 Q. Do you have some personal knowledge and you also
25 mentioned that there were 60 or so other similarly situated

1 people that run routes, mostly home delivery routes like
2 yours. Do you have knowledge of whether most of those are
3 also run the same way, managed the same way?

4 A. Yes, they are.

5 Q. They would be small businesses?

6 A. We're all independent drivers, yes, so we're all
7 responsible to bill and collect and sign-up customers.

8 Q. And we talked a lot about your home delivery
9 customers, but you mentioned, I think, some small espresso
10 shops, and --

11 A. Uh-huh.

12 Q. -- was it daycares also?

13 A. Yes.

14 Q. And those would be -- in your opinion, would
15 those be small businesses as well?

16 A. Yes, they are.

17 Q. And you mentioned that these are markets that you
18 feel have been under-served by other processors at this
19 point, is that true?

20 A. Yes.

21 Q. Is that something that your customers tell you as
22 well?

23 A. Yes, it is. Yeah, they can't -- a lot of my
24 customers can't get anybody else to deliver.

25 Q. And why is that? Is that because of the volume

1 they're looking for?

2 A. Some of my espressos will take six or eight half
3 gallons, and two whipped cream and you know, it varies
4 every time. And they've been told by some of the
5 companies, want them to order a pallet load or they're not
6 going to get anything.

7 Q. And that's a lot of times and we heard some
8 testimony earlier this week, but I don't think that you
9 were here for, but for one reason, is that a lot of these
10 smaller places simply don't have the storage for larger
11 volumes.

12 A. That's correct.

13 Q. And you're able to visit them on an as-needed
14 basis and provide small amounts to fit their needs.

15 A. Yes, that's correct.

16 Q. Okay.

17 MS. REED: I don't have any other questions right
18 now. Thanks a lot for your testimony, and the witness is
19 available.

20 THE COURT: Thank you. Do we have questions for
21 the witness from proponents? Go ahead, Mr. Berde.

22 EXAMINATION

23 BY MR. BERDE:

24 Q. Mr. Ellis, my name is Sydney Berde.

25 A. Hi.

1 Q. You mentioned in the course of your testimony
2 something about the fact that you know that Smith Brothers
3 is a producer/handler.

4 A. Yes.

5 Q. What does that mean to you?

6 A. That we produce our own milk and we bottle it
7 ourselves and that what I tell our customers is, we know
8 what our cows get and more importantly, what they don't
9 get.

10 Q. And that's all it means to you?

11 A. Yes.

12 Q. So you don't know anything about Smith Brothers'
13 regulatory status with the Secretary, do you?

14 A. No.

15 Q. So there really would be no change in your
16 description of your activities or your relationship with
17 your customers if Smith Brothers were regulated or
18 unregulated, would it?

19 A. As long as we produce our own milk, that's the
20 only point to me.

21 MR. BERDE: Thank you.

22 THE WITNESS: Uh-huh.

23 THE COURT: Go ahead, Mr. Beshore.

24 EXAMINATION

25 BY MR. BESHORE:

1 Q. Marvin Beshore for Dairy Farmers of America.

2 Good morning, Mr. Ellis.

3 A. Good morning.

4 Q. There was some reference, I think my memory is
5 right in Ms. Kester's (phon.) testimony to leasing routes
6 to distributors. Is your -- do you lease your route?

7 A. No, sir, I own that route.

8 Q. Are you supplied at any of -- there are a number
9 of products that you provide for your customers.

10 A. Yes.

11 Q. Do you get all those products from Smith
12 Brothers?

13 A. Yes, I do.

14 Q. The eggs?

15 A. Yes.

16 Q. The yogurt?

17 A. Yep.

18 Q. Do they make the yogurt?

19 A. No, sir.

20 Q. Who makes the yogurt?

21 A. We have Yammi (phon.) Yogurt.

22 Q. Pardon me?

23 A. We have Yammi.

24 Q. Okay. Do you know who processes that?

25 A. Auburn Dairy Products, I believe.

1 Q. Auburn Dairy Products?

2 A. Yes, sir.

3 Q. Do you know where they're located?

4 A. I think in Auburn.

5 Q. Auburn, Washington?

6 A. Yes.

7 Q. I think you -- okay. I think you indicated you
8 offer aphfadolphous milk.

9 A. Yes, sir.

10 Q. Okay. Who processes that?

11 A. Smith Brothers.

12 Q. The -- let's talk about the comments. You said
13 if I -- if my notes are right, that you're basically the
14 only show on the road.

15 A. Home delivery-wise, I think so.

16 Q. Okay. And the same thing goes for the smaller
17 espresso-type accounts that you mentioned; is that correct?

18 A. I don't understand what you mean.

19 Q. Are you the only show on the road for those small
20 espresso accounts you have?

21 A. Pretty much. Yeah, they have a hard time getting
22 delivery, uh-huh.

23 Q. How many times do you deliver there?

24 A. Depending on the size of the espresso, once a
25 week, twice a week.

1 Q. What do you charge them for your delivery
2 service?

3 A. That's kind of private business information, and
4 I choose not to reveal today.

5 Q. Okay. Do you charge them more if you deliver
6 twice than if you deliver once a week?

7 A. No, sir.

8 Q. Is it based on volume at all, your charges?

9 A. No, I have a pretty standard price I try to stay
10 by.

11 Q. Okay. Are they just -- do you charge just a
12 product price or a product plus a delivery service?

13 A. No, just a product price.

14 Q. So for, you know, a half gallon of two percent
15 milk, is it the same price to an espresso as it is to a
16 home customer?

17 A. No, it's a little less to the espresso.

18 Q. They don't -- how do you -- what's your mark-up
19 from Smith Brothers prices from your prices?

20 A. Somewhere between 30 and 40 percent.

21 Q. And do you establish that at a level to cover
22 your costs and make an income for yourself?

23 A. Yes.

24 Q. How often do you change your prices to your home
25 customers, or to any of your customers?

1 A. Once a year, maybe twice a year, if I need to.

2 Q. How often does Smith Brothers change its prices
3 to you?

4 A. Once or twice a year maybe, maybe more.

5 Q. And what's the current price you're paying for a
6 half a gallon of two percent milk from Smith Brothers?

7 A. That's all proprietary. I'd rather not disclose
8 that.

9 Q. What -- and is that the same answer to what
10 you're charging your home delivery customers?

11 A. Yes, sir.

12 Q. If you -- can you share with us the relationship,
13 if you know it, between the price that you charge for a two
14 percent half gallon of milk to the price that -- in the
15 supermarket?

16 A. I think I'm competitive. I think most grocery
17 stores have two brands of milk in the grocery store, and I
18 come in about -- between the store brand and the upper
19 brand.

20 Q. Is your business expanding?

21 A. Mine is.

22 Q. Yours is.

23 A. Uh-huh.

24 Q. You're adding customers all the time?

25 A. I think I have to all the time, otherwise, I'd be

1 shrinking. I've got to stay knocking on doors every day,
2 yes, sir.

3 Q. How many customers did you have when you started
4 out?

5 A. Boy, that was a long time ago. I think I
6 probably had three, four or five hundred.

7 Q. And you've got between 800 and a thousand now?

8 A. Yes, sir.

9 Q. So you have one employee. Do each of you have a
10 truck and you're making two routes every day?

11 A. Yes, sir, that's correct.

12 Q. Thank you.

13 THE COURT: Go ahead, Mr. English.

14 EXAMINATION

15 BY MR. ENGLISH:

16 Q. You testified about the number of hours you work.
17 Do you have any idea the number of hours that are put in by
18 employees at regulated plants?

19 A. No, I don't.

20 MR. ENGLISH: Thank you.

21 THE COURT: Anymore questions from the proponents
22 side? Questions from Ms. Deskins?

23 MS. DESKINS: Charlene Deskins, also General
24 Counsel USDA.

25 EXAMINATION

1 BY MS. DESKINS:

2 Q. Where is your business located?

3 A. My particular route?

4 Q. Yes.

5 A. I'm in the Kent/Renton/New Castle/Covington area.

6 Q. And that's north of Seattle; is that right?

7 A. South of Seattle.

8 Q. South of Seattle.

9 A. Yes, ma'am.

10 Q. Okay.

11 MS. DESKINS: That's all the questions I have,
12 thank you.

13 THE COURT: Do you have any redirect?

14 MS. REED: No, Your Honor.

15 THE COURT: Okay. Thank you very much for your
16 testimony, you may step down.

17 And what are you going to do now?

18 MS. REED: (Inaudible).

19 THE COURT: He just went to get the witness?

20 Okay. We're going to just -- we might as well go off the
21 record. We're going to wait a few minutes, and I guess Mr.
22 Yale is going to come down with the next witness; is that
23 correct?

24 MS. REED: Yes.

25 (A break was held.)

1 THE COURT: Okay. We're back on the record. Mr.
2 Yale, are you now ready to call your next witness?

3 MR. YALE: Yes. Continuing with our tradition of
4 smooth transitions to expert witnesses, Ben Yale on behalf
5 of Smith Brothers Dairy, Edaleen Dairy and Mallory's Dairy,
6 I -- we have called to the stand Dr. Ronald D. Knutson, who
7 although I'm not representing them, he is also testifying
8 on behalf of Sarah Farms.

9 THE COURT: Okay. Let me swear you in first, Mr.
10 Knutson. If you'd please raise your right hand.

11 DR. RONALD D. KNUTSON, WITNESS, SWORN

12 THE COURT: Okay. And would you state and then
13 spell your name for the record.

14 THE WITNESS: Ronald D. Knutson, R-o-n-a-l-d,
15 initial D, K-n-u-t-s-o-n.

16 THE COURT: Okay.

17 EXAMINATION

18 BY MR. YALE:

19 Q. Good morning, Dr. Knutson.

20 A. Good morning.

21 Q. What is your business address?

22 A. My business address at 1011 Rose Circle in
23 College Station. I'm a professor emeritus at Texas A & M
24 University. I still have an office at Texas A & M
25 University in College Station.

1 Q. And do you have in front --

2 MR. YALE: What would the next exhibit be, Your
3 Honor?

4 THE COURT: The next exhibit would be 43.
5 (Exhibit No. 43 was marked.)

6 Q. (By Mr. Yale) Do you have in front of you a copy
7 that talks about Dr. Knutson dairy resume?

8 A. Yes.

9 Q. All right. And was this prepared by you?

10 A. Yes, it was.

11 Q. And what does this describe or represent?

12 A. This represents all of the work I've done with
13 respect to dairy and dairy economics. I have a much more
14 extensive resume in the general area of agricultural
15 policy, but I limited this one just to the dairy area.

16 Q. Can you give me some of the highlights of your
17 educational background?

18 A. Yes. I received my bachelor's degree from the
19 University of Minnesota longer ago than I want to admit.
20 And my master's degree from Pennsylvania State University,
21 and then I received my Ph.D. from the University of
22 Minnesota.

23 Q. And what about -- has basically your employment
24 been in that of academia?

25 A. Well, except for a period with USDA in the early

1 1970s or mid-1970s, when I was the Chief Economist of the
2 Agriculture Marketing Service and then the administrator of
3 the Farmer Cooperative Service in USDA.

4 Q. And you indicated you're now a professor emeritus
5 at Texas A & M?

6 A. Yes.

7 Q. And during, I think with the resume, it's
8 indicative that you've done a lot of work in dairy
9 economics over the years.

10 A. I have, yes.

11 Q. All right. Let me talk about -- you said there's
12 some broader areas. Have you written any or authored any
13 textbooks dealing with agricultural economics?

14 A. Yes. I am the author of the Standard
15 Agricultural Policy Textbook used in the United States,
16 titled Agriculture and Food Policy. It's in its Fifth
17 Edition.

18 Q. And have you testified before as a witness
19 involving dairy economics and other forum?

20 A. Yes, I have.

21 Q. And what are some of those? I mean, not
22 necessarily the cases really matters, but the types of
23 forum that you have --

24 A. I've testified in a limited number of federal
25 order hearings. I've testified in a state order hearing in

1 Pennsylvania. I've testified in a large number of what
2 should I call, an anti-trust-type unfair trade practice-
3 type court proceedings.

4 Q. This document that's identified as Dr. Ronald D.
5 Knutson's dairy resume, is this true and accurate to the
6 best of your knowledge?

7 A. It is.

8 MR. YALE: Your Honor, we would move that Exhibit
9 43 be admitted.

10 THE COURT: Okay. I'll mark it as Exhibit 43 and
11 I will admit it into evidence.

12 (Exhibit No. 43 was received.)

13 Q. (By Mr. Yale) Dr. Knutson, have you been
14 retained by four producer handlers to prepare -- to analyze
15 testimony that's been presented at this hearing and to
16 present evidence to the Secretary regarding this matter?

17 A. I have.

18 Q. And what are those -- who are those
19 producer/handlers?

20 A. The producer/handlers are Edaleen Dairy, Mallory
21 Dairy, Sarah Farms and Smith Brothers Dairy.

22 Q. And this -- first of all, what do you understand
23 the primary issue of this hearing to be?

24 A. The primary issue in this hearing is limitation
25 of three million pounds per month on volume to qualify for

1 an exemption from Class One pricing and pooling provisions
2 of the orders, of the two orders.

3 Q. And that is for a producer/handler?

4 A. Yes.

5 Q. And what is a producer/handler?

6 A. A producer/handler is a producer or handler that
7 both produces milk and processes milk in its operation,
8 Class One milk.

9 Q. Is this sometimes considered to be an integrated
10 or vertically integrated operation?

11 A. Yes, it is.

12 Q. Is it uncommon that dairy has producer/handlers?

13 A. No, I think --

14 Q. Compared to other commodities?

15 A. Well, it depends upon which commodities you're
16 talking about. I think the -- the dairy industry has
17 always had producer/handlers. They've always existed in
18 the U.S. There's a number of other industries that are
19 more highly integrated by a longshot than dairy; poultry,
20 pork, there are two classic examples. But, you know,
21 integration is becoming very common in agriculture.

22 Q. Have producer/handlers existed outside of federal
23 orders?

24 A. Yes. Yes, they have.

25 Q. So they're not a creature of the federal order

1 system?

2 A. No. No.

3 Q. Did you prepare a written statement concerning
4 your views and analysis that you've done?

5 A. Yes, I have.

6 Q. For this hearing?

7 A. Yes, I have.

8 Q. Do you have a copy in front of you?

9 A. Yes, I do.

10 Q. Mr. or Dr. Knutson, I would ask if you would
11 please present that into the record.

12 MR. YALE: By the way, Your Honor, we'd like to
13 have that marked as Exhibit No. 44. There are a number of
14 footnotes that we'd like to be able to have access to.

15 THE COURT: Okay. I've just marked Dr. Knutson's
16 written statement or testimony as Exhibit 44.

17 (Exhibit No. 44 was marked.)

18 MR. YALE: And we would move that also be
19 admitted as an exhibit, and then I will --

20 THE COURT: With not hearing any objection, I'll
21 admit Exhibit 44 into evidence.

22 (Exhibit No. 44 was received.)

23 Q. (By Mr. Yale) Dr. Knutson, if you would proceed.

24 A. Thank you.

25 My name is Dr. Ronald D. Knutson. I am a

1 professor of emeritus at Texas A & M University, and reside
2 at 1011 Rose Circle in College Station, Texas.

3 At Texas A & M I served for 28 years as a
4 professor and for 13 years, as a director of the
5 agricultural and food policy center, which primary task
6 involves completing studies of the impacts of proposed
7 changes and policy for the U.S. Congress.

8 Prior to accepting the Texas A & M position, I
9 was the Chief Economist of USDA's Agricultural Marketing
10 Service and the administrator of its Farmer Cooperative
11 Service.

12 Throughout my 40 years as a professional
13 agricultural economist, my primary research area has been
14 dairy marketing and policy. In this capacity, I've served
15 as the chairman of two USDA milk pricing advisory
16 committees. One evaluated the Minnesota/Wisconsin
17 manufacturing milk pricing series, and the other evaluated
18 pricing and classification options for Federal Milk
19 Marketing Order reform.

20 I have attached my professional resume related to
21 my work as a dairy economist. Upon request, I will supply
22 my complete resume.

23 I have been engaged by producer/handlers, well,
24 I'll call them PHs, you can also them call PDs, who would
25 be directly and adversely impacted by the proposed three

1 million pound per month --

2 (tape change.)

3 -- of pooling provisions of the Pacific Northwest
4 and Arizona/Las Vegas Milk Marketing Orders.

5 I have concluded that the proposed actions
6 represent a stop gap regulatory measure that will curve
7 competition within the milk industry, deny customers,
8 consumers and wholesale buyers an efficient direct from
9 producer source of milk of supply, and effectively
10 discriminate against small businesses, which our government
11 is mandated to protect.

12 In drawing my conclusion, I have interviewed and
13 compiled information on regulated producer handlers in
14 Seattle and Phoenix Federal Order Markets, studied economic
15 conditions in these markets, studied past USDA decisions on
16 the producer/handler issue, and studied past USDA reports
17 on the objectives of Federal Milk Marketing Orders.

18 Utilizing these analyses, I will testify to one,
19 the evolving economic and technical environment in which
20 producer/handlers compete. Two, the meeting of orderliness
21 as applied to Federal Milk Marketing Orders. Three, the
22 true origins of the regulatory issue that has lead to the
23 stop gap regulatory proposal. Four, the serious technical
24 errors made by Mr. Herbine, Mr. Kryon and Mr. Holland, who
25 have testified in support of this stop gap measure, and I

1 will identify a series of misleading or unsubstantiated
2 statements and generalizations made by Mr. Herbine, Dr.
3 Kryon and Mr. Holland, that are not based on facts and
4 sound analysis.

5 If the proposed three million pound limit is put
6 into effect, it will be but another example of one
7 regulatory mistake designed to deal with another regulatory
8 mistake. However, in this case, it would be to the
9 material disadvantage of the progressive small business
10 operators that our government is supposed to protect, and
11 in fact, will put several of them out of business.

12 My comments on the existing and evolving economic
13 climate are designed to tie together and point out those
14 dairy industry conditions that have particular relevance to
15 the proposal to limit Class One and pooling exemption to
16 producer/handlers processing three million pounds or less a
17 month.

18 Large multi-plant processors, large national
19 retailers, and large cooperatives dominate the dairy
20 industry. While this has been the case in the industry for
21 many years, it is more true today after the agglomerations
22 of many formerly independent processors in the Dean Foods
23 and national dairy holdings.

24 The consolidation of many local and retail
25 grocery chains into national change, such as Kroger and

1 Safeway, and the merger of many cooperatives in the DFA and
2 Land O'Lakes, were often characterized either as case of
3 monopsony, meaning a single buyer or monopoly, meaning a
4 single seller, this structure is more commonly labeled,
5 more correctly labeled, excuse me, trilateral oligopoly,
6 meaning high levels of concentration on all three sides of
7 the market.

8 Less attention is given to the competitive fringe
9 of smaller independent processors that has largely
10 disappeared due to many factors, including their lack of
11 ability to realize economies of size, their inability to
12 serve the needs of large retailers, their inability to
13 compete with large processors, their inability to adapt to
14 rapidly changing market for milk, and the fact that they
15 are -- they were family -- there were family farm members
16 or family members, excuse me, who desired to get their
17 equity out of the business, which they often saw
18 disappearing in value.

19 A similar statement of fact can also be made with
20 regard to the disappearance of the fringe of smaller
21 grocery retailers, although in this case, the market power
22 of traditional large grocery chains has been offset by the
23 rise of membership stores, such as Sam's Club and Costco
24 and of the growth of Wal-Mart.

25 Entry into the marketplace for fluid milk and its

1 products is limited by large producers, large retailers,
2 and by dominant cooperatives that have full supply
3 contracts for most of the raw milk in and entering Federal
4 Order markets.

5 In this environment, a captive milk supply or a
6 captive outlet for milk often is the only way to get into
7 the milk processing business. That is, one simply does not
8 see new independent processors in a competitive-sized range
9 that buy milk directly from producers entering the market.

10 The Class One pricing and pooling and exemption
11 has provided a long-standing market niche opportunity to
12 dairy entrepreneurs having expertise in both production and
13 processing, to compete in the dairy industry.

14 Modern producer/handler operations provide an
15 opportunity for a resurgence of an efficient, competitive
16 fringe adapted to today's dairy -- today's industry
17 marketing conditions.

18 While the challenges of being able to operate
19 both a dairy farm and a milk processing plant are great,
20 the development of this fringe represents a societal
21 benefit, in terms of maintaining competitive markets for
22 milk at all market levels.

23 Streamline vertically integrative firms are
24 thriving and setting the pace for competition at an
25 increasing share of today's agriculture. Such new

1 structures are controversial to traditional processors,
2 producers, and their organizations.

3 This is the case in the same sense as Wal-Mart
4 and Sam's Club have been controversial challenges to
5 traditional processors and grocery chains.

6 It would be a serious mistake to nip such
7 fledgling operations in the bud, by government regulation.
8 Likewise, it would be a mistake to curtail a growth of
9 producer/handlers to an efficient and competitive scale of
10 operation.

11 The modern milk industry is also characterized by
12 consumers who have different wants, desires and needs for
13 milk and milk products. Today's consumers are highly
14 diverse, ranging from poor migrant laborers who must shop
15 for the lowest cost sources of milk to an increasingly and
16 fluent segment that will pay to have milk and its product
17 delivered to their homes.

18 These vastly different market segments create
19 opportunities for firms, such as producer/handlers to serve
20 niche markets, such as home delivery, direct to consumer
21 sales. Products perceived to have superior quality and
22 products having particular characteristics desired by
23 consumers.

24 If the dairy industry is to resume a pattern of
25 growth, it must be sufficiently flexible to efficiently

1 serve these diverse needs. In addition to producing for
2 such market niches, producers overcome some of the
3 disadvantages of smaller size by processing limited product
4 lines or container lines with high levels of efficiency.

5 In an era of increasingly intense competition
6 with carbonated beverages and soy products, the dairy
7 industry cannot afford to be hang-strung by a pattern of
8 stop gap regulations having the effect of stifling change
9 and innovation.

10 The producer segment of the industry is
11 undergoing a rapid and progressive technological
12 revolution. This is more than just an issue of the growth
13 and development of the 380 large dairy farms having over
14 2,000 cows that in January of 2002, produced 15 percent of
15 the milk, on which this proposal will cast further
16 regulation.

17 An additional or alternative growth strategy for
18 these dairies involves producer/handler innovations and
19 marketing to serve the wants and desires of a diverse
20 consumer market for milk and its products.

21 The Cornell University analysis of cost of fluid
22 milk plants relied upon by Mr. Herbine, Dr. Kryon and Mr.
23 Holland, demonstrates that economies of size and milk
24 processing require a minimum size of dairy to implement the
25 innovations that the proposed limits on size or design to

1 regulate and stifle.

2 It is important to note that the minimum size
3 plants studied by the Cornell scientists were nearly four
4 times the three million pound threshold proposed to be
5 subject to Class One pricing and pooling regulation in
6 Federal Order 124 and Federal Order 131.

7 The minimum size of plants studied by Cornell was
8 approximately the size of the largest producer/handler on
9 whose behalf my study and my testimony was developed.

10 The producer/handler operations at issue are a
11 diverse in their mix of customers, products and containers.
12 Although some do business through distributors, some run
13 their own routes, for some portion or all of their
14 business.

15 While emphasis is generally placed upon a line of
16 products with a limited number of containers, some producer
17 surprisingly large product line and container mix, their
18 customers tend to be a mix of convenience stores, smaller
19 independent supermarkets, schools, coffee shops,
20 restaurants, institutions and home delivery sales.

21 Their surplus amount which generally accounts for
22 a small proportion of their production or sales, is sold to
23 a wide array of outlets, sometimes at price discounts.
24 Substantial price discounts, I might add.

25 Customer feedback indicates that consumers buy

1 producer/handler milk because of its perceived higher
2 quality, its freshness, its taste, and because they know
3 where it comes from. And in some cases, because it does
4 not contain RBST.

5 Customers view producer/handlers as offering
6 better service, being more responsive, and being more
7 flexible. Although several offer milk produced without the
8 use of aid of RBST, their output per cow is highly
9 competitive and generally what one would expect for a
10 cutting edge dairy farm.

11 This is the first of a series of regulatory
12 challenges resulting from rapid technological change in the
13 dairy industry. Others include the use of reverse osmosis
14 and alter filtration to modify non-fat solids, content of
15 milk, to create new beverage uses for milk and to expand
16 the utilization of milk components.

17 While the industry, with the help of the
18 government, can curb the use of such new technologies and
19 strategies by regulation, as it has in the past and
20 proposes to do in this hearing, a more progressive strategy
21 would be to use federal milk marketing orders to facilitate
22 change and to serve the many market niches that exist in
23 the milk business.

24 In the current and evolving dairy industry
25 environment, there is a need for competition offered by

1 independent and innovative firms that have historically
2 been the source of progress in the American dairy -- in the
3 American economy.

4 Studies demonstrate that small businesses are
5 very important agents of change and of technological
6 innovation in the American economy. Another landmark study
7 of innovation found that small firms have 2.5 times as many
8 innovations related to the number -- relative to the number
9 of people employed as large firms and that small firms
10 bring their innovations to market faster than large firms.

11 The government and its regulators have a special
12 obligation to foster and protect these innovative small
13 businesses. In 1980, Congress enacted the Regulatory
14 Flexibility Act to require federal agencies to analyze the
15 impact of federal laws and small businesses and to consider
16 meaningful alternatives that would achieve the agency's
17 goal without unduly harming small business.

18 The current policy is consistent with this
19 policy. While a proposed policy would be inconsistent
20 because it will stifle producer/handlers innovations in
21 fluid milk production processing and distribution.

22 It is ironic to me that Mr. Holland, on behalf of
23 DFA would testify against the interests of the 380 dairy
24 farmers, who are the largest and most efficient small
25 business operations in the dairy industry.

1 It is even more surprising that this growing
2 segment would be referred to as statistical outliers, when
3 they account for 15 percent of the milk production. In the
4 future, these dairy industries will account for the
5 majority of DFA's volume, or it will not exist as a
6 cooperative.

7 The concepts of orally marketing, public
8 interest, and adequate supply permeate the statutory
9 authorization for federal milk marketing orders. This
10 proposal to regulate the pricing and pooling of Class One
11 milk produced by -- produced and processed by
12 producer/handlers would equate the meaning of orderliness
13 to the pricing of all milk in the market, regardless of
14 whether it's bought or sold. In other words, the emphasis
15 in the proposal is on mechanics.

16 Orderliness, as defined by the experts who
17 defined the term, places emphasis on results. The milk
18 pricing advisory committee, the then Assistant Secretary
19 Lang (phon.) addressed orderliness' definition as follows
20 and I quote:

21 "Orderliness in a market context is the opposite
22 of chaos. It is several different dimensions. It implies
23 prices, which achieve reasonable balance between production
24 and consumption. Orderliness implies short-term protection
25 of a market from unwarranted movement of supplies. At the

1 same time it implies adjustment of supply to least cost
2 sources, as well as to regional changes in production
3 costs.

4 "Orderliness implies a proper relation between
5 fluid and surplus prices, as well as between blend and
6 manufacturing prices. It implies the establishment of
7 relations between producers and handlers, which facilitate
8 fair, but not disruptive competition among producers and
9 handlers, while encouraging the establishment of reliable
10 channels of trade.

11 "At the same time, it implies protecting the
12 rights of producers to choose their market outlet free of
13 coercion and unreasonable barriers to entry -- to market
14 entry."

15 The Milk Pricing Advisory Committee developed
16 this definition by building on the earlier objectives for
17 Federal Milk Marketing Orders from the much quoted Norse
18 report -- Norse Committee (phon.).

19 The important point is that both the -- both
20 advisory committees to USDA placed emphasis on results, not
21 on mechanics. This means finding evidence of market
22 disruption and chaos. Likewise, both emphasis -- both
23 placed emphasis on fostering competition and adjustment to
24 ever-changing economic conditions within the dairy
25 industry.

1 The concepts of equitable treatment, not equal
2 treatment, rights of producers to choose, and freedom of
3 trade are mentioned by both advisory committees.

4 The relevance of the orderliness definition to
5 this hearing lies in the question of whether there exists
6 evidence in the two Federal Order Markets, that the
7 producer/handler exemption has led to disorderly marketing
8 conditions.

9 In a word, have the Class One pricing and pooling
10 exempt producer/handlers created chaos. My study indicates
11 no evidence of disorderliness as a result of
12 producer/handler exemption, in any of the terms identified
13 in either the milk pricing advisory committee, or the Norse
14 Committee.

15 Specifically, while there may be excess
16 production, it cannot be argued that it is due to the
17 activities of producer/handlers. But rather, would be the
18 result of excessive Class One prices. There have not been
19 unwarranted movements of milk supplies. Producer/handlers
20 can be argued to have facilitate adjustment to a milk
21 supplies to lease cost sources (sic.).

22 There is no evidence of disruptive competition.
23 My analysis indicates that Seattle processors have enjoyed
24 some of the highest gross margins in the United States.
25 The Phoenix market's gross margin lies close to the median

1 of the major U.S. Federal Order markets.

2 Channels of trade remain reliable, in that
3 producer/handlers have found a reasonable -- a reasonably
4 stable niche in the markets that they serve.

5 Producer/handlers are subject to the loss of accounts like
6 any other processor, as indicated by the experience of
7 Edaleen Dairy with the Starbuck's account in Seattle.

8 Was that account transfer evidence of disorderly
9 marketing? As I understand, Safeway captured the
10 Starbuck's account. Should Federal Order regulations be
11 changed to prevent such transfers? If producer/handlers
12 have an advantage, how can this transfer of accounts be
13 explained?

14 Based on these generally accepted definitions of
15 disorderly marketing, it is evident that conditions in the
16 Arizona/Las Vegas Order and the Pacific Northwest Order are
17 not conducive to disorderly marketing. Furthermore, the
18 testimony of Mr. Holland and other witnesses who testified
19 in Phoenix does not point to activity that would warrant a
20 change in regulation or policy.

21 At best, these witnesses have expressed a fear
22 that future growth of market share by producer/handlers
23 would disrupt the market. However, the economic
24 considerations that foster growth and regulatory -- in the
25 regulatory environment that would permit such growth, have

1 existed for at least a decade and these fears have not
2 materialized.

3 Contrary to the proponent's assertions, the sky
4 is not falling. And important decisions like the one
5 before the Secretary should not be made on speculation
6 about events that history has shown are unlikely to occur.

7 Federal Milk Marketing Orders have been used to
8 accomplish price enhancement objectives, for which they
9 were never designed. Federal Milk Marketing Orders were
10 designed to compensate for producers for the cost of
11 serving the Class One market.

12 Setting Class One prices at a level that more
13 than compensate producers for the cost of serving the Class
14 One market unduly increases the prices paid by processors
15 for milk used for fluid purposes.

16 Federal Milk Marketing Order price enhancement is
17 augmented by over order premiums tacked on to the Class One
18 price by cooperatives, which has complicated the pricing
19 problem for Federal Milk Marketing Order regulators.

20 The Class One price was further enhanced by the
21 Federal Milk Marketing Order Reform Decision to set the
22 Class One price at the higher of the Class Three price or
23 the Class Four price.

24 Dairy farmers responded to the higher Class One
25 price by increasing production, which drives down the fluid

1 utilization and the blend price. Thus, Class One -- the
2 Class One utilization has fallen from 62 percent in 1975,
3 for Central Arizona Federal Order to 32 percent for the
4 Arizona/Las Vegas Federal Order in 2001.

5 Similarly, Class One utilization has fallen from
6 41 percent in 1975 for the Pudget Sound Federal Order to 30
7 percent for the Pacific Northwest in 2001. The increases
8 in the Class One price has pushed down the blend price, and
9 increased the margin between the Class One price and the
10 blend price. The size of the alleged loophole that Mr.
11 Holland refers to has been determined by the lobbying of
12 activities of DFA and National Milk Producers Federation
13 who now proposes to close the loophole it created by its
14 excesses.

15 For the Pudget Sound and successor Pacific
16 Northwest Federal Orders, the Class One differential was
17 increased in December 1989 from 185 per hundred weight to
18 190 per hundred weight. The cooperative premium tacked on
19 an additional simple average of 67 cents per hundred weight
20 to 1 90 per hundred weight Class One -- to the 1 90 per
21 hundred weight Class One differential, with a range from 30
22 percent per hundred weight to \$2.13 per hundred weight.

23 For the Arizona and successor federal order, the
24 Class One differential was reduced from 2 52 per hundred
25 weight to 2 35 per hundred weight in 2000. The cooperative

1 premium did not exist until December 1999, when it was set
2 at 60 cents per hundred weight.

3 In August 2000, the cooperative premium was
4 reduced to 15 cents per hundred weight. The biggest recent
5 contributing factor to higher Class One prices was the
6 higher of provision to Milk Marketing Order reform (phon.),
7 which added an average 1 05 per hundred weight to the Class
8 One price compared to a weighted average of the Class Three
9 and Class Four price.

10 High Class One prices, including cooperative
11 premiums have been a contributing factor to increased
12 production, to reduced fluid milk consumption, and resulted
13 in CCC stock accumulation, lowered the producer blend price
14 and provided incentives for expansion of producer/handler
15 operations.

16 The proposal will limit the producer/handler
17 exemption from Class One pricing and pooling to three
18 million pounds per month is a consequence of a Class One
19 price that is too high. Excessive Class One prices have
20 been fostered by political pressure from producer
21 organizations, and by the market power of dairy
22 cooperatives that do not acknowledge their consequences.

23 Lowering federal milk marketing order Class One
24 price and/or over-order premiums would reduce incentives
25 for producer/handler expansion. Such a strategy, of

1 course, would require an admission of strategic error in
2 judgment by cooperative leaders acting through the National
3 Milk Producers Federation. Instead, the political strategy
4 of inflicting pain on producer/handlers was selected.

5 Mr. Holland indirectly recognizes the
6 contribution of excessive Class One prices as a
7 contributing factor to disorderliness in milk markets,
8 stating that its consequence is to expand the so-called PH
9 loophole in federal milk order -- a federal regulation that
10 will completely undermine the federal order system.

11 The true culprit in expanding the alleged
12 loophole that would prevent processors, who are not
13 producer/handlers from competing, is not the
14 producer/handler Class One pricing and pooling exemption.
15 It is the excessive Class One differential that over-order
16 premiums that have stipulated excess milk production, which
17 forces producer blend prices down and leads to manufactured
18 dairy products flowing into the hands of the Commodity
19 Credit Corporation.

20 Assuming that the type of growth alleged by the
21 proponents, it is not surprising that Sarah Farms' growth
22 accelerated following Federal Order reform, and the
23 adoption of higher -- and the adoption of higher up
24 pricing. By advocating higher up pricing DFA and National
25 Milk Producers widened Mr. Holland's loophole, and not

1 seeks to regulate producer/handlers out of existence.

2 The proposed strategy reflects a prevailing
3 industry philosophy, that there exists a regulatory
4 solution to every problem. The consequent requirement is
5 for a series of stop gap measures designed to plug
6 loopholes, resulting from the unforeseen consequences of
7 regulatory decisions. In the process, there is an inherent
8 danger that industry progressiveness and competition are
9 stifled.

10 A number of errors were made by economists
11 testifying for the proponents of the proposed three million
12 pound per month limit on producer/handlers to be exempt
13 from Class One pricing and pooling provisions of the
14 Pacific Northwest and Arizona/Las Vegas Federal Orders.
15 There was a failure on the part of each of the economists
16 to recognize the problem as being the level of Class One
17 price. There is a serious error that it -- in that it
18 reflects the pervasive problem of looking at individual
19 issues in isolation and embracing a stop gap regulatory
20 measure as opposed to reflecting on why the problem exists,
21 and suggesting action to deal with it.

22 Mr. Kryon's explanation of the principles that
23 underlie the producer distributor Class One pricing and
24 pooling exemption was distorted and misleading. He
25 attributes the exemption to resistance by producer/handlers

1 to file reports with the Federal Order Milk Market
2 administrators and their refusal to make payments into the
3 pool.

4 According to Dr. Kryon, this producer -- that is
5 producer/handlers were exempt from regulation as a matter
6 of administrative expediency. This statement in addition
7 to being downgrading of the ability of Federal Milk Market
8 Order administrators to perform their responsibility,
9 ignores the history of the exemption contained in the 1998
10 pure milk decisions and the 1993 -- excuse me. 1999 Pure
11 Milk decisions and the 1993 Heartland (phon.) decision.

12 In the Pure Milk Decision, the USDA rejected a
13 proposal to limit the Class One pricing and pooling
14 exemption to producer/handlers, who limit their
15 distribution to home delivery and to processor-own store
16 sales. It also rejected the proposal to differentiate
17 among producer/handlers on the basis of size. In so
18 deciding, the USDA indicated that quote, in fact, the
19 policy has been to exempt such types of regulation. Such
20 policy has been based generally on findings in regulatory
21 proceedings that producer/handlers have no significant
22 advantage in the market in their capacity as either
23 handlers or producers, as long as they are solely
24 responsible for their production and processing facilities,
25 and assume essentially the entire burden of balancing their

1 production with their fluid milk requirements.

2 The Pure Milk Decision goes on to indicate that
3 while USDA has the authority to regulate producer/handlers,
4 quote, however on the basis of overall history of the
5 treatment of producer/handlers a size consideration in and
6 of itself is not particularly relevant to the issue.

7 Even large operations, in relation to the markets
8 they serve have continued to be exempt from full
9 regulation. Consequently, any decision to fully regulate a
10 producer/handler-type operation must be supported by
11 substantial evidence of the existence of disorderly
12 marketing, that is a direct result of producer/handler
13 activity.

14 The Heartland Decision dealt largely with the
15 issues of buying needed Class One milk at the Federal Order
16 minimum regulated price, and the sharing of the costs of
17 handling surplus and install a means for producer/handlers
18 to bear their share of the costs for maintaining the
19 reserve supply of milk. In doing so, it rejected a
20 proposal by the National Milk Producers Federation to limit
21 the size of a producer/handler.

22 In the case of both the Pure Milk and Heartland
23 Decisions, the role of Federal Milk Marketing Orders was
24 one of assuring that producer/handlers were treated
25 equitably in the markets in which they deal, not to

1 restrict the size of their operations. In other words, the
2 emphasis is on results.

3 Dr. Kryon failed to consider and recognize this
4 USDA Federal Milk Marketing Order policy regarding the
5 treatment of producer/handlers. There was a failure to
6 utilize sound statistical methods. For example, Mr.
7 Herbine's sample of 20 fluid milk plants was far too small
8 to be of any use in establishing predicted values. From a
9 statistical prospective, drawing conclusions from a sample
10 size of less than 30 can lead to highly tenuous results.

11 Only two of the plants were producer/handlers.
12 Both being substantially smaller than the producer/handlers
13 impacted by their proposal. Yet, Mr. Herbine generalizes
14 that all of the plants were producer/handlers. Mr.
15 Herbine's sample plants were located outside of the
16 Arizona/Las Vegas and almost entirely outside of the
17 Pacific Northwest orders, which substantially no
18 demonstrated comparability of product mix, processing, or
19 distribution conditions.

20 Even at that, there was no indication that they
21 were randomly selected. In fact, there was adverse
22 selection, in that these plants were not only
23 representative of the producer/handler niche, they were
24 also small firms that had, for years, had problems
25 surviving.

1 In other words, Mr. Herbine's data represents an
2 unrepresentative worst case scenario that is completely
3 useless in this hearing.

4 Then an error was made in making regional costs
5 adjusted by using the consumer price index, rather than the
6 producer price index. It can readily be concluded that Mr.
7 Herbine's testimony is no value in either drawing
8 conclusions -- the conclusion he reached, or as a basis for
9 decisions regarding the proposal to fully regulate
10 producer/handlers.

11 Dr. Kryon's analysis, likewise fails to use sound
12 statistical methods. He makes the fatal mistake of basing
13 his analysis on the obviously faulty analysis of Mr.
14 Herbine. Then Dr. Kryon implies in Table 1-B, that the
15 cost curve fitted to Mr. Herbine's data is nearly a perfect
16 fit. Allegedly explaining 98 percent of the cost
17 variation.

18 This obviously is not the case, since the R
19 squared coefficient should've been calculated using
20 individual cost observations of plant costs for the 20
21 plants, not on average costs for different size plants.

22 The R square using individual observations
23 would've been substantially lower. Data are not provided
24 to determine how much lower the R square would've been, had
25 it been correctly calculated.

1 It is also extremely important to recognize that
2 size is not only -- that size is only one of the factors
3 influencing plant efficiency and competeness. The proposal
4 limiting the exemption to three million pounds per month,
5 as well as the expert testimony of Dr. Kyron and Mr.
6 Herbine implied that size is the sole or at least the major
7 factor influencing efficiency and competitiveness. This is
8 highly misleading.

9 The Cornell (phon.) Study found that there were
10 at least 17 different factors influencing efficiency and
11 competitiveness including one, whether the plant is a captive
12 or supermarket chain. Whether it is a cooperative plant.
13 Three, the wage level in the area. Four, whether the plant
14 is unionized. Five, the percent utilization of capacity.
15 Six, the number of stock keeping units processed. Seven,
16 size of plant. Eight, the percent of products handled on
17 pallets. Nine, the degree of automation or technology and
18 processing. Ten, the degree of automation and technology
19 in the cooler and load-out. Eleven, the population
20 density. Twelve, the number of miles traveled per month in
21 delivery. Thirteen, the percent of plant capacity
22 utilized. Fourteen, the size and mix of customers.
23 Fifteen, the milk -- the delivery method. Sixteen, the
24 type of delivery vehicles utilized and seventeen, the
25 percent of milk delivered to the customers' docks.

1 The point is, that picking one of these factors
2 and utilizing it as the basis for regulation has anecdotal
3 characteristics that are not useful in drawing conclusions
4 that must be based upon science-based facts. Meaning, that
5 they can be replicated and verified.

6 Mr. Holland likewise falls into the trap of using
7 statistics and statistical methods that are not sound
8 including, one, the reliance on the unrepresentative plant
9 cost data presented by Mr. Herbine. This makes his whole
10 analysis of the advantages accruing to producer/handlers
11 from Class One price -- from the Class One pricing
12 exemption faulty and unreliable.

13 Then Mr. Holland states that producer/handlers
14 would easily be able to gain market share at will, without
15 being able to demonstrate that this has happened. The
16 statement that producer/handlers and/or volume are growing
17 rapidly was not substantiated.

18 In fact, utilizing his own estimates combined
19 with historical USDA data would appear to suggest the
20 contrary. Specifically, from 1980 to 1998, the last year
21 for which USDA reported producer/handler data, the volume
22 of milk sold in the United States by producer/handlers has
23 declined from 1.4 -- 1.47 billion pounds, 1.14 percent of
24 production to 1.16 billion pounds, 0.73 percent of
25 production.

1 Mr. Holland's estimates indicate that in 2003 the
2 volume remained at 1.6 billion pounds. These data do not
3 confirm the rapidly growing seg -- producer/handler segment
4 that Mr. Holland indicates. Data on current
5 producer/handler numbers in volume were set forth where
6 USDA indicates that there's no such reliable data.

7 Four, estimates were made by Mr. Holland of the
8 number of stores served by producer/handlers based on
9 incomplete and therefore unreliable data. They were
10 designed by smaller stores. They are by design smaller
11 stores that are disappearing just like small producers and
12 small processors.

13 Conclusions drawn by Mr. Herbine contain a number
14 of generalizations that are not substantiated by these
15 analysis. These include, one, without realizing or
16 considering the implications of his flawed statistical
17 analysis, Mr. Herbine draws the unsubstantiated conclusion
18 that the 2,000 pound per month size -- that at the 2,000
19 pound per month size, a producer/handler can be fully
20 competitive with regulated plants on a cost or processing
21 packaging basis.

22 There is no way that he could reliably make this
23 statement, when his sample did not include any
24 producer/handlers that fall in this size -- category.

25 The implication of Mr. Herbine's testimony that

1 producer/handlers are not regulated is not true. They are
2 regulated by Federal Milk Marketing Orders. They are not
3 required to pay the Class One price, because they buy no
4 Class One milk from producers. They produce their own
5 milk.

6 The implication that large producer/handlers only
7 serve large wholesale customers is not true. There are all
8 types of customers served by producer/handlers. While
9 noted previously, there are producer/handlers that serve
10 large customers in competition with large processors,
11 there's also an emphasis by producer/handlers to serve
12 markets that may not otherwise be served. Such as with
13 RBST Free Milk or home-delivered milk.

14 The best way to characterize the producer/handler
15 strategy is one of concentrating their operations on
16 serving market niches.

17 The implication by Mr. Herbine is that since --
18 four, excuse me. The implication by Mr. Herbine is that
19 since vertically integrative producer/handlers are
20 competitive, they have an unfair advantage.
21 Producer/handlers have built their better -- built a better
22 mouse trap to serve specific market niches with their set
23 of skills.

24 In doing so, they have taken on increased risks
25 of both production and processing. This is a

1 characteristic of many integrated businesses. As a general
2 rule, the U.S. Government is not allowed to turn around and
3 penalize firms that find ways to be competitive.

4 Five, the overt statement is made by Mr. Herbine
5 that large producer/handlers have an unfair advantage over
6 small producer/handlers. How could this possibly be since
7 they both operate under the same rules? Greater
8 efficiency, vertical integration and more effective
9 marketing have never been interpreted as an unfair
10 advantage in the American economy.

11 In fact, when considering the increased risk of
12 performing both production and processing functions, I'm
13 convinced that producer/handlers have no discernible
14 competitive advantage.

15 Conclusions drawn by Dr. Kryon likewise contained
16 a number of generalizations that are erroneous or that are
17 not substantiated by his analysis.

18 These include, first: Dr. Kyron implies that the
19 only basis for Class One -- for the producer/handler Class
20 One and pooling exemption was and is that the USDA simply
21 gave up on getting producer/handlers comply or that their
22 records were so bad that they could not be audited.

23 Well that may have been part of a history. As
24 noted previously, the policy of USDA has been one of
25 supporting producer/handler Class One pricing and pooling

1 exemption. However, it is not clear to me that USDA has
2 the authority to price producer/handler milk as Class One,
3 since the milk is never purchased by a producer/handler.

4 The legal authority would appear to apply only to
5 milk purchased by a producer/handler. There is no
6 transaction or sale of milk between the producer/handler's
7 farm and its processing plant. The producer/handler is a
8 single business entity. This interpretation is consistent
9 with the Pure Milk and Heartland decisions. Moreover, any
10 imposed penalty on producer/handlers would be the
11 equivalent of a tax on their operation.

12 The implication by Dr. Kryon that
13 producer/handlers are not regulated is not true. They are
14 not required to pass the Class One price, because they buy
15 no Class One milk.

16 The statement by Dr. Kyron that producer/handlers
17 enter the bottling market purely to exploit this regulatory
18 basis has no supporting foundation. A producer can grow by
19 adding more cows or by adding value to what is produced.
20 Exploitation has nothing to do with either avenue.

21 Four, the Class One pricing exemption does not
22 rob the pool, as stated by Dr. Kyron. Since
23 producer/handlers draw nothing from the pool and do not
24 participate in the pool, how could they rob the pool? By
25 law, the only firms that have an obligation to pay into the

1 pool are those who buy milk.

2 The Class One pricing -- five. The Class One
3 pricing exemption has nothing to do with the economic
4 concept of dead weight loss, as stated by Dr. Kryon. The
5 economic concept of dead weight loss implies a loss to
6 society, due to reduced production, reduced sales, and
7 increased prices. Price discrimination as practiced in
8 Federal Milk Marketing Orders imposes a dead weight loss.
9 There is no dead weight loss to society in the
10 producer/handler Class One pricing exemption. There would
11 be a dead weight loss due to reduced competition from the
12 higher price if the exemption did not exist.

13 Six, Dr. Kryon contends that the Class One
14 pricing and pooling exemption is a threat to orderly
15 marketing. He begins this line of argument by implying
16 that large farms having over three million pounds of milk,
17 of production, are a threat to orderly marketing because
18 they might all decide to become producer/handlers. If
19 there were the case, there would be many more
20 producer/handlers throughout the country than currently is
21 the case.

22 The only threat of large producers to other
23 producers is that they have been more innovative and have
24 become more efficient. Dr. Kryon argues that
25 producer/handlers are able to package milk at a lower price

1 and implies that this is a threat to orderly marketing.

2 As a dairy economist, I have problems with the
3 notion that a lower price that results in more sales
4 represents disorderly marketing. Moreover, he presents no
5 evidence that producer/handlers do sell milk at a lower
6 price.

7 I analyzed the retail price structure in both
8 Seattle and Phoenix markets from 1994 to October 2002 and
9 reviewed prices that are in the record of this hearing.
10 Aside from differences in the time period studied, my
11 research used the actual price paid by handlers from the
12 cooperative for Class One milk, rather than the Federal
13 Milk Marketing Order minimum price.

14 In both studies, the Seattle market was found to
15 have one of the highest, if not the highest, gross producer
16 -- gross processor retailer margin in the United States.
17 If Dr. Kyron were right that producer/handlers drive down
18 milk product prices, the Seattle market would benefit from
19 more producer/handler competition.

20 The gross margin for the Phoenix Market appears
21 to be in the middle of the market study. In neither case
22 is there any case of disorderliness. Dr. Kyron's balancing
23 argument is stated in sufficiently unclear terms that is
24 not decipherable. If the argument is that
25 producer/handlers do not pay the cost of balancing, this is

1 factually unsupported.

2 The proposed remedy being pursued is unrelated to
3 the cost of balancing. Somehow Dr. Kyron relates the
4 balancing issue to payments into the pool. Since
5 producer/handlers do not buy milk, they neither make
6 payments into the pool, nor draw from the milk. They're
7 obligated to do their own balancing, but it is not at the
8 expense of either producer or handlers. If this were the
9 case, there would be evidence in retail prices.

10 Dr. Kryon states that justification provided --
11 excuse me. Seven. Dr. Kyron stated justification for
12 provided for the three billion pound per month was that
13 three million pounds is the limit for exemption from
14 payment of the fluid milk promotion assessment.

15 It is ridiculous to suggest that limits set under
16 another program provide justification for applying the same
17 limit to producer/handlers. Then there is an indication
18 that the break even ought -- the breakpoint ought to be set
19 low in case it is readjusted, so that uneconomic
20 investments are not lost. This may be interpreted as
21 setting the limits sufficiently low that no one can survive
22 as a producer/handler.

23 In other words, National Milk Producer Federation
24 desires to get rid of producer/handlers, as a competitive
25 force within the dairy industry. Even though it purports

1 to represent U.S. milk producers.

2 Mr. Holland's testimony also contains a number of
3 generalizations and assumptions that are erroneous and/or
4 not substantiated, including. First, no data was presented
5 on prices producer/handlers receive for either Class One
6 milk that is purchased or surplus milk that is sold.
7 Instead, Mr. Holland assumed that the Federal Order prices
8 prevail.

9 My interviews with producer/handlers indicated
10 that cooperatives paid substantially less than the Federal
11 Order minimum price for surplus milk purchased by
12 producer/handlers. He assumed that increased competition
13 results in disorderly marketing. In the process he ignored
14 retail price evidence, indicating that there was no
15 disorder created in the structure of prices. New
16 competition and account switching is normal market behavior
17 and not -- and certainly not evidence of chaos.

18 Three, he assumed that it is the role of Milk
19 Marketing Orders to enforce over-order premiums. Orders
20 only set minimum prices for milk that is sold.

21 Based on the above analysis, it is my conclusion
22 that it would be a serious mistake to adopt any limit at
23 which producer/handlers would be required to account to the
24 pool at minimum Class One price for the following reason.

25 First, producer/handlers make no purchases of raw

1 milk and should not be taxed for being efficient and
2 innovatively marketing the milk they produced, and is
3 preferred by certain market segments.

4 Two, there is no appropriate and objectively
5 determined volume cap that can be placed on regulation of
6 prices paid by producer/handlers.

7 Three, the proposed actions represent stop gap
8 regulatory measures that will curb competition within the
9 milk industry. Curbing competition is itself disorderly,
10 in that it would be a destructive barrier to entry of new
11 firms in the milk processing and distribution.

12 Four, the proposal will deny consumers and
13 wholesale buyers an efficient, direct from producer source
14 of milk supply.

15 Five, the proposal will effectively discriminate
16 against small businesses, which our government is mandated
17 to protect.

18 Six, economists testifying have not proven the
19 existence of disorderliness in either of the Federal Order
20 Markets. Moreover, they failed to present any analysis to
21 prove that disorderly marketing conditions in the dairy
22 industry have developed in recent years.

23 Seven, the true cause of any advantage accruing
24 to producer/handlers which is the higher Class One price
25 has not been taken account of in the proponent's testimony.

1 Eight, serious analytical errors were made by
2 experts, who have testified in support of the proposal.

3 And nine, a series of misleading or
4 unsubstantiated statements and generalizations, which were
5 not based on facts and sound analysis were made by the
6 experts.

7 Thank you.

8 Q. Thank you, Dr. Knutson.

9 Dr. Knutson, who's indicated before, we have as
10 an exhibit, I believe, 44 is a copy of your prepared
11 statement. And as you read, there may have been times when
12 there was some misreading or changes. Is it your position
13 that what you spoke is what you wanted your testimony to be
14 or what was in the written proposal?

15 A. What I had in the written proposal is what I
16 intended.

17 Q. Thank you.

18 Now, you indicated earlier both in terms of your
19 resume and some general discussion of your expertise or
20 your academic history and training, that you have reached
21 the point of an emeritus professor at Texas A & M.

22 In your role as a professor at Texas A & M and in
23 academia, have you been called upon from time to time to do
24 peer review of research?

25 A. I have, yes.

1 Q. And what is peer review of research? How would
2 you describe that?

3 A. It involves equally qualified people in the
4 profession to review the work of other people in the
5 profession, papers, their research.

6 Q. And what is the purpose of that? I mean, what's
7 the role of the peer review?

8 A. It's a screening exercise to make sure that what
9 is published is accurate.

10 Q. Now, I realize that in all fairness, the reports
11 provided to this hearing were not intended to necessarily
12 be published. But do the study by Dr. Herbine, does it
13 approach the type or level of discipline that one would
14 expect in a peer review article?

15 A. Absolutely not.

16 Q. And are any of the conclusions or first of all,
17 are any of the methodologies that were described in that
18 testimony consistent with what would be accepted in a peer
19 review?

20 A. No.

21 Q. And what about the conclusions?

22 A. Well, the conclusions have to be based upon the
23 methodology, so they are equally invalid.

24 Q. Now, the -- you identified a Cornell study
25 regarding Class One or -- I mean, bottling, processing and

1 the like. Do you recall that?

2 A. Yes.

3 Q. Is that a peer review article?

4 A. Yes, it was.

5 Q. Do you recall whether you participated in that
6 peer review?

7 A. As a matter of fact I didn't, but there is a
8 group of dairy economists across the country that did
9 review that publication.

10 Q. Now, in -- there was a couple of points I want to
11 just clarify or to expand upon that are in your written
12 statement.

13 You mentioned early on that there seems to be
14 this battle between mechanics versus results. And first of
15 all, explain if you would, what you mean by the term the
16 mechanics and the results and how you see that.

17 A. A mechanic is a regulation that's based upon a
18 physical relationship or factor in the market. The three
19 million pound limit is a mechanical limit. It has nothing
20 to do with results. It is, as best as I could figure out,
21 selected on an arbitrary basis. None of the experts seemed
22 to present any rationale for three million pounds that
23 makes any sense from an economic standpoint. It may make
24 sense from a political standpoint.

25 So the issue of mechanics versus results ends up

1 being one of a regulation that states a limit that has no
2 apparent basis to it, versus what were the consequences.
3 And it's not consequences in terms of what might happen,
4 it's not speculation. It's what has happened in the
5 marketplace.

6 Q. And you're referring to the development of
7 producer/handlers --

8 A. Yeah, yeah. I mean, if all of the travesties
9 that have been listed in the expert testimony, in fact,
10 would've happened. We -- they would be able to point to
11 these results. Surely the volume handled by
12 producer/handlers would have substantially increased.
13 Surely the number of producer/handlers would have
14 substantially increased. Those are results.

15 Surely there would be chaos in terms of market
16 prices. But that's not demonstrated to exist. These are
17 markets that either have average prices that exists
18 throughout the United States, or have among the highest
19 prices that exist in the United States.

20 So these are results that you would have to look
21 to, you know, to substantiate the conclusions reached by
22 the experts.

23 Q. Does the AMA -- you're familiar with the
24 Agricultural Marketing Agreement Act that sets up the
25 Federal Orders?

1 A. Yeah, I'd say I'm reasonably familiar with it,
2 yes.

3 Q. And is it one that the Congress has directed --
4 (tape changed.)

5 Q. -- mentioned chaotic price. What's a chaotic
6 price? How would -- what would be an evidence of chaotic
7 pricing?

8 A. Well, chaotic pricing would be pricing that goes
9 radically up and down in the marketplace, where you see
10 wide variation in prices in the marketplace. Where people
11 in the marketplace are engaging in highly competitive price
12 cutting, which some -- there's some allegations that they,
13 in fact, occurred. But there's no evidence. There's no
14 hard data to support the notion that there was, you know,
15 unfair competition, if you will in the marketplace.

16 Q. In determining whether there's chaotic pricing in
17 the marketplace, is the evidence of an individual account
18 moving from one processor's milk to another-type of
19 evidence that you would look for or is that evidence of
20 something else?

21 A. It's certainly not evidence I would look for.
22 Accounts in the milk business, transferring from one firm
23 to another are not all that unusual. I mean, look at the
24 Starbuck's account is a classic, as I note in my testimony.

25 If you call a producer/handler getting a Sam's or

1 Costco account unfair competition or chaotic disorderly
2 marketing, then surely the acquisition of the Starbuck's
3 account by Safeway has to be equally classified as chaotic
4 or disorderly marketing. And surely the subject of this
5 hearing should include then, what do we do about this
6 Starbuck's account transferring from one firm to another.

7 Transfer of accounts are very common in the milk
8 business and it's certainly not evidence of disorderly
9 marketing.

10 Q. Isn't the transfer of accounts from firm to firm
11 sometimes evidence of efficiencies in the marketplace?

12 A. It's evidence of efficiency and it's evidence of
13 competition. It's evidence of innovation.

14 Q. Now, you spent some time talking about the change
15 in the Class One utilization as the Class One price, do you
16 recall that?

17 A. Yes.

18 Q. I want to -- is it your understanding then that
19 the increase in the Class or the decrease in the Class One
20 utilization is contributing to lower blend prices?

21 A. Yes.

22 Q. All right. Would a mechanic to reduce this
23 reduction be -- that's a terrible way to say that. I'm
24 going to withdraw that question. Let me start again.

25 Would a mechanic to offset this reduction that

1 occurred in the blend price from higher non-Class One
2 utilization be to put limits upon producers, either in
3 their participation of the pool or their ability to expand?

4 A. No.

5 Q. But wouldn't that -- isn't that an argument that
6 is equal to putting a cap on the PDs?

7 A. Oh, it is.

8 Q. So it's a --

9 A. Yes.

10 Q. So it's a choice then between what mechanic
11 you're going to pick or another, right?

12 A. Yes.

13 Q. And you talk about the setting of the cap of the
14 three million, I think you indicated it was an -- it's an
15 arbitrary number. If their argument is that if the PDs
16 aren't -- can get too big to compete with the processors,
17 is it just as logical to say that maybe we ought to put a
18 cap on the size of the processors so they don't get too big
19 to put out the PDs?

20 A. It is, but moreover, it is a ludicrous argument
21 to say that producer/handlers are going to get so large
22 that they're going to put a Dean Foods or a Safeway or a
23 Kroger that operates in markets throughout the United
24 States out of business or severely injure them.

25 I mean, these are individual producers. These

1 are small businesses competing against giants economically
2 in the milk business. And to argue that these small
3 businesses are going to put the giants of the industry out
4 of business or do severe injury to those giants is -- like
5 I say, it's a ludicrous argument.

6 Q. Then just for some clarification and mostly for
7 someone who -- and maybe the department already understands
8 this, but I'd like to be able to understand it so I can
9 explain it better.

10 But you talk about the R square dealing with I
11 believe Dr. Kyron's testimony.

12 A. Yes.

13 Q. Would you explain what R square is?

14 A. R square is the percent of the variation in this
15 way -- in this case, the variation in cost that is
16 explained by size.

17 Q. Okay.

18 A. In other words, how much of the costs variation
19 related to different size plants is explained, in
20 percentage terms and a conclusion drawn, I guess it was by
21 Mr. Kryon, that 90 percent -- 98 percent of the variation
22 was explained by size and there's very serious problems
23 with that.

24 Q. And those problems are what?

25 A. Well, when you -- they're based on an average.

1 In other words, what they did is they created a cost curve,
2 based upon averages for different sized plants, without
3 considering the cost of the individual plants. And an R
4 square should be based upon individual plant costs and to
5 suggest that 98 percent of the variation was explained is
6 wrong. If it's -- it's how to lie with statistics, if you
7 will.

8 Simply because he did not calculate the IR square
9 based upon the cost of the individual plants. He
10 calculated based upon the averages for different sized
11 plants, and of course, that would lead to a high R square.
12 It's a favorite gimmick of people who want to lie with
13 statistics.

14 Q. Now, the -- as a result of that, he developed a
15 curve or described a bit of a curve that kind of seemed to
16 make a movement of three million pounds; is that correct,
17 or was that part of his analysis that came to that?

18 A. I'm not sure I can follow what you're --

19 Q. All right. We won't follow up with that then.

20 MR. YALE: Your Honor, I'm done with direct at
21 this time.

22 THE COURT: Okay. Well, I note that it's just
23 about 12:25. So why don't we come back at 1 --

24 MR. UNIDENTIFIED: Go ahead. I have a question.

25 THE COURT: Why don't we come back 1:30 for

1 cross-examination, and which --

2 MR. UNIDENTIFIED: I just want to know if there
3 are other witnesses ready to go for the opponents? I'm
4 hoping -- well, I'm hoping we can be rather efficient and
5 be ready to go, but I just want to know if the other
6 witnesses are ready or not.

7 MR. UNIDENTIFIED: We were going to try to keep
8 the hearing moving.

9 MR. UNIDENTIFIED: Okay. That's all I wanted.

10 MR. UNIDENTIFIED: Cross-examine (inaudible).

11 THE COURT: Yeah, once again, my plan is that
12 around 3:00 -- we lose the room, so around 3 -- some of you
13 might have missed this, but around 3:45 when I call the
14 next break after lunch, we're going to move upstairs and my
15 plan would be that if we have -- if witnesses are ready, we
16 go to around 7:00 o'clock tonight.

17 MR. YALE: I'd like to discuss a matter of
18 official notice either now or at the return.

19 THE COURT: Let's go back to lunch and come back
20 at 1:30.

21 (A break was held.)

22 THE COURT: Okay. We're back on the record.

23 And the witness, Dr. Knutson, is available for
24 cross-examination. Mr. English, are you going first?

25 MR. ENGLISH: Yes, Your Honor. Charles English.

EXAMINATION

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BY MR. ENGLISH:

Q. Dr. Knutson, I'm here for Dean Foods Company and Shamrock Foods Company.

Doctor, if we could start first with the sources of information you used to prepare for your testimony. What written materials did you review for this testimony?

A. Well, I reviewed the statements of Mr. Herbine, statement of Mr. Kryon, statement of Mr. Holland. I reviewed -- the only testimony from the hearing that I actually reviewed -- cross-examination I should say was Mr. Yates from Dean. I reviewed the milk price and retail and producer price information developed by USDA, and as a part of the record in this hearing. I had previously been doing some work of my own with regard to processor retailer margins. And so I went back and updated that for both of these markets that are the subject of this hearing.

I went back and reviewed the Milk Pricing Advisory Committee Report and the Norse Report. I reviewed the decision with respect to Pure Milk and the decision with respect to Heartland. That's pretty complete.

I spent a little bit of time this morning reading Van Dam's testimony, but did not get all the way through it. I looked at the tables that I gather were a part of his testimony.

1 Q. Is that all the written materials you reviewed?

2 A. Yeah, to the best of my recollection it is.

3 Q. I should back up for a moment.

4 By whom are you engaged for this proceeding?

5 A. I'm engaged by Edaleen Dairy, Mallory's Dairy,
6 Sarah Farms and Smith Brothers Dairy.

7 Q. And when were you engaged?

8 A. Approximately six weeks -- no, probably eight
9 weeks ago. I had an operation in between, so I had some
10 time off.

11 Q. I'm sorry to hear that. I hope you're well.

12 If you were engaged approximately eight weeks ago
13 and had some time when you were unable to work, about how
14 much time have you spent on this project?

15 A. I think -- I didn't look before I came down here,
16 probably somewhere around 60 hours.

17 Q. Now, beyond reviewing written materials, I'm
18 right that you have not been in the hearing room either in
19 Phoenix or here in Seattle prior to today, correct?

20 A. No, and I wasn't in prior to my arrival here as a
21 witness today either, so.

22 Q. So you just came in for your direct testimony and
23 cross, correct?

24 A. That's the way I like to operate, yes.

25 Q. And so now let me discuss what perhaps -- I just

1 want to make clear you haven't reviewed.

2 I take it from your testimony you did not review
3 the testimony of Mr. Keith Muirfield (phon.) for United
4 Dairymen of Arizona?

5 A. No.

6 Q. And I take it from your testimony that you did
7 not review the testimony of Mr. Mike Kruger (phon.) for
8 Shamrock Foods.

9 A. No, I did not.

10 Q. And I take it from your testimony you did not --
11 from your testimony, that you did not review the testimony
12 of Mr. Norman McClellan (phon.) for Shamrock Farms?

13 A. No.

14 Q. And other than the testimony, a portion of the
15 testimony reviewed by Mr. Van Dam earlier today, you have
16 not reviewed any of the testimony that's been given here in
17 Seattle, correct?

18 A. No.

19 THE COURT: Just to clarify, when you say no, you
20 mean yes to his question that you haven't?

21 THE WITNESS: I have not reviewed --

22 Q. (By Mr. English) Those things.

23 A. -- any of the testimony presented. I -- except
24 for what I've indicated, and it's only the formal written
25 statements, except for that of Mr. Yates that I have read.

1 Q. And with whom have you spoken concerning your
2 testimony, in preparation for the testimony?

3 A. Most of my time has been spent with the Counsel
4 for Edaleen, Mallory's and Smith Brothers and then the
5 Counsel for Sarah Farms. But more time with the Counsel
6 for Edaleen, Mallory and Smith Brothers, than for Sarah
7 Farms.

8 Q. Of your 60 hours, how much of the 60 hours was
9 discussing matters with Counsel?

10 A. Oh, boy, not many. Maybe four. Maybe four.

11 Q. And the bulk of --

12 A. Four hours.

13 Q. And the bulk of those four hours would've been
14 spent discussing with Mr. Yale?

15 A. Yes. Maybe not even that much time actually.

16 Q. Three hours?

17 A. Yes.

18 Q. And the bulk of the three hours would've been
19 with Mr. Yale?

20 A. Yeah.

21 Q. Did you interview Mr. Heinhennehke (phon.) for
22 your testimony before giving your testimony?

23 A. Yeah. I've -- no. Well, no, not as such. I had
24 a set of questions that I wanted to get information so that
25 I was familiar with the client's operations that I'm

1 representing here.

2 Q. Did you prepare that set of questions?

3 A. I prepared that set of questions, yes. There are
4 things that I wanted to know about the operations just to
5 be familiar, to be able to draw some general conclusions
6 with respect to the operations.

7 Q. And did you use the same set of questions for
8 each of the clients?

9 A. I did, yes.

10 Q. And did you communicate directly with each of the
11 clients with the set of questions?

12 A. No, with Sarah Farms I did not communicate
13 directly. I had conference calls with the Edaleen, Mallory
14 and Smith Brothers. In the case of Sarah Farms, I received
15 a written transcript of the questions -- of the answers to
16 the questions.

17 Q. To whom did you submit the questions?

18 A. Directly to the dairies.

19 Q. And so in the case of Sarah Farms, you submitted
20 the questions and received a written response, correct?

21 A. Yeah.

22 Q. And in the case Edaleen, Mallory's and Smith
23 Brothers, you submitted the questions and then had one
24 conference call with all of them?

25 A. No, no, separate one with each one.

1 Q. Okay. Separate one with each one.

2 A. Yes.

3 Q. Can you tell us what the questions were that you
4 asked?

5 A. Well, I can, but I'm not going to discuss the
6 answers, because they were confidential. I'd be glad to
7 discuss generally my impressions regarding the overall
8 answers. But --

9 Q. Well, first of all, let me start with, are you
10 prepared to tell us what the questions were?

11 A. Yes. I -- if I could remember all of them. I
12 probably can't remember what all of them were. It's
13 basically, you know, when did you begin producing milk.
14 When did you become a PD. Why did you become a PD. What
15 is your output per cow. Why do consumers -- why do your
16 customers do business with you. How many cows do you milk.
17 What would happen if you lost the exemption from Class One
18 pricing and pooling. Oh, what's your product mix. What's
19 your customer mix. That's probably fairly complete. I may
20 have mixed one question, but.

21 Q. Did you ask them how they disposed of surplus
22 milk?

23 A. Oh, yes, you're right. That's the one in
24 addition that I asked them. What is your high volume month
25 compared to your low volume month and what percent of your

1 milk is surplus on the average for the year.

2 Q. Did you ask them about what they do to purchase
3 or obtain additional milk supplies?

4 A. No, I didn't get into that issue.

5 Q. Did you ask them how many farms they had?

6 A. No.

7 Q. Did you ask them location of the farms?

8 A. Oh, I asked them, yeah, where they were located,
9 yeah. You know, generally speaking.

10 Q. Did Sarah Farms tell you whether any of their
11 farms were located in California?

12 A. No.

13 Q. Did Sarah Farms tell you how many farms they had?

14 A. They may have, but I don't recall exactly. I
15 couldn't name exactly where -- how many there are, where
16 they're located.

17 Q. Did you ask the producer/handlers about the
18 location of their plants?

19 A. No.

20 Q. Did you ask the producer/handlers how many plants
21 they have?

22 A. No.

23 Q. Are you aware whether Sarah Farms or the owners
24 of Sarah Farms have an interest, ownership interest in
25 other one or more facilities in Arizona, California or

1 Nevada?

2 A. One or more facilities, you're going to have to
3 be --

4 Q. Plants. Plants.

5 A. Vaguely, but not specifically.

6 Q. What do you know vaguely?

7 A. Well, I can recall discussions of multiple
8 operations, but when it got into the detail, I didn't see
9 any need to do that.

10 Q. And I take it from an earlier answer if I asked
11 you what specific answers were for specific questions, you
12 would not provide those?

13 A. No. This was a confidential discussion in all
14 cases.

15 Q. And I understand that and I respect that, I just
16 wanted to make sure that was the answer.

17 Now, you mentioned that you reviewed the Pure
18 Milk. What did you call the Pure Milk proceeding?

19 A. The Pure Milk Federal Order Decision.

20 Q. And you reviewed the decision in Heartland,
21 correct?

22 A. Yes. Yes.

23 Q. Did you review any other producer/handler
24 promulgation, amendment, hearing, proceeding, decisions,
25 other --

1 A. No.

2 Q. -- than those two provided by Counsel for the
3 opponents?

4 A. The answer is no.

5 Q. You said you reviewed the Norse Report, correct?

6 A. Yes.

7 Q. Rather long report?

8 A. Yes, it is. It's a classic.

9 Q. Did you read the entire report?

10 A. Oh, I've read the entire report several times.

11 Q. You quoted from one part of the Norse Report,
12 correct?

13 A. Well, actually I did not quote from the Norse
14 Report.

15 Q. Oh.

16 A. I quoted from Milk Pricing Advisory Committee. I
17 seriously thought about quoting from the Norse Report, but
18 I decided my testimony was already getting to be too long,
19 so.

20 Q. Do you recall whether the Norse Report refers to
21 producer/handlers, producer/distributors in any way?

22 A. Yes.

23 Q. Do you recall what the Norse Report has to say
24 about the regulation or not regulation of
25 producer/handlers?

1 A. I don't recall exactly, no.

2 Q. But in your 60 hours of preparation, you didn't
3 find or remember today that there might be such a provision
4 in the Norse Report?

5 A. I recollect that, but I did not review it.

6 Q. Let me see if I can refresh your recollection.

7 A. Okay.

8 Q. And if you'll accept my representation, but see
9 if this refreshes your recollection.

10 The real question, whether at page 62, that's not
11 the important part of the question, but whether page 62 of
12 the Norse Report from 1962, the Norse Report says as
13 follows:

14 "Historically, exemption from regulation has been
15 given to certain handlers, particularly publicly-
16 owned processors and producer distributors.
17 Little justification exists today for exemption
18 from regulation and only under the most unusual
19 circumstances, should such exemption be granted."

20 A. Yep. I believe that.

21 Q. Does that refresh your recollection?

22 A. I believe that that's what they probably said.

23 Q. Now, you refer a number of times in your
24 testimony and indeed conclusion number one,
25 producer/handlers make no purchases of raw milk and should

1 not be taxed for being efficient and innovatively marketing
2 the milk they produce and is preferred by certain milk
3 segments.

4 That's on page 14. You earlier refer on page 12
5 in criticizing Dr. Kyron the implication that Dr. -- that
6 producer/handlers are not regulated is not true. They are
7 not required to pay the Class One price, because they buy
8 no Class One milk. Do you recall that testimony, correct?

9 A. Yes.

10 Q. Have you ever read the Ideal Farms case from the
11 Third Circuit?

12 A. No, I haven't.

13 Q. Are you even familiar with the Ideal Farms case
14 from the Third Circuit?

15 A. No, I'm not.

16 Q. Have you ever read the case of Freeman versus
17 Vance from the Fifth Circuit?

18 A. No.

19 Q. Are you even familiar with the Freeman versus
20 Vance case from the Fifth Circuit?

21 A. I am not.

22 Q. Would you be familiar that either case -- in both
23 cases, (indiscernible) was denied by the United States
24 Supreme Court?

25 A. No.

1 Q. Are you familiar with the Acme Brewer's case?

2 A. No.

3 Q. Isn't it true, sir, that in each of those cases,
4 the courts and subsequently USDA have repeatedly held that
5 this issue of whether or not milk was purchased is
6 irrelevant for regulation of producer/handlers?

7 A. They may have.

8 Q. I take it you've never read the decision by the
9 Secretary in the handling of milk in New York, New Jersey
10 dated January 24, 1958?

11 A. No.

12 Q. Having to do with producer/handlers?

13 A. No.

14 Q. And I take it you've never read the decision
15 number 6598 and the M-Culture Decisions (phon.) before the
16 Secretary of Agriculture, United States Department of
17 Agriculture, dated January 4, 1961, independent milk
18 producer distributors association?

19 A. No.

20 Q. Are you aware in that decision, there was
21 discussion about orderly and disorderly marketing as
22 concerns to producer/handlers?

23 A. No. Since I haven't read it, I wouldn't be.

24 Q. And so your conclusions and your testimony today
25 are not based on any of the materials from that decision,

1 correct?

2 A. Right.

3 Q. Are you aware of a decision from this very
4 marketing area that we sit in today, actually with the
5 Pudget Sound at the time, but now part of the Pacific
6 Northwest, dated 1965? It's 7 CFR Part 1125, Docket No.
7 AO-226-A11. Are you familiar at all with that decision
8 regarding producer/handlers?

9 A. No.

10 Q. Are you familiar with the fact -- well, then
11 you're not familiar with the fact that in that proceeding,
12 producer/handlers in this very market claimed that in the
13 Pudget Sound market, they cannot be subjected to full
14 regulation inasmuch as they sell milk and milk products
15 solely within the State of Washington and not interstate
16 commerce, and they do not sell it to anyone other than
17 themselves. Would you be aware of that?

18 A. No.

19 Q. Would you be aware that the Secretary said
20 neither claim is valid?

21 A. No.

22 Q. You're not aware of the Secretary specifically
23 addressed the issue of the Class One price and the
24 difference between the Class One price and the blend price
25 in that decision?

1 A. No.

2 Q. Now, on page five of your testimony, near the
3 bottom you say the concepts of equitable treatment paren,
4 not equal treatment, rights of producers to choose and
5 freedom of trade are mentioned by both Advisory Committees
6 --

7 A. Yes.

8 Q. -- do you recollect that testimony?

9 A. Yes.

10 Q. Now, first, where does the word equitable appear
11 in 5 USC 608C -- 6 USC 608C, sorry?

12 A. It probably does not, but the point is, that
13 that's what these advisory committees had to say about the
14 issue.

15 Q. Isn't the term used in the Agricultural Marketing
16 Agreement Act, minimum uniform prices?

17 A. Sure, absolutely.

18 Q. Paid by handlers.

19 A. Oh, yes, but producer distributors do not pay for
20 their milk.

21 Q. Do you want me to --

22 A. They produce it.

23 Q. So you insist that producer/handlers do not pay
24 for milk and therefore, not regulated, correct?

25 A. They do not pay -- well, they may buy a little

1 bit, and in that case, they will pay the Class One price.
2 But they don't. They do not pay for the milk that they
3 produce.

4 Q. But you say that without ever having read Freeman
5 versus Vance, Acme Brewers or Ideal Farmers, correct?

6 A. That's true.

7 Q. Okay. Well, --

8 A. I don't think that proves anything.

9 Q. You think your statements of what the law are
10 better than the courts?

11 A. Well, no, I just used logical reasoning. The
12 logical reasoning is that they don't buy the product, so
13 they don't pay for it. I mean, that seems completely
14 reasonable and logical to me. I don't know how you would
15 possibly conclude that the producer/handlers in this market
16 pay for their milk.

17 Q. And that's a significant element of your
18 testimony, correct?

19 A. It's a significant point, it certainly is, yes.

20 Q. So, sir, you testified earlier that you're
21 familiar with the AMAA, correct?

22 A. Yes.

23 Q. Are you familiar with the provision of 7 USC 608C
24 5C?

25 A. Which states?

1 Q. In order to accomplish the purposes set forth in
2 paragraph A, having to do with uniform payments by
3 handlers, and B, having to do with uniform payments by
4 producers, those are parenthesis by me of this subsection,
5 providing a method for making adjustments in payments, as
6 among handlers, including producers who are also handlers,
7 to the end, the total sums paid by each handler shall equal
8 the value of the milk purchased by him at the prices fixed
9 in accordance with paragraph A of this subsection.

10 A. I'm familiar with that.

11 Q. Okay. But you don't know that the courts have
12 said contrary to your statement that they do not pay, that
13 that subjects them to full regulation.

14 A. No. Simply because they haven't been subjected
15 to full regulation.

16 Q. But if the Court said they can be, then you're
17 wrong, right?

18 A. I don't think I'm wrong. I'm simply stating that
19 logic leads you to believe, you know, they don't buy milk.
20 I mean, that's the reality of it.

21 Q. If that statement is true --

22 A. So what you're saying is, that the law says that
23 they can impose a tax on these people, because that's pure
24 and simple what it is.

25 Q. Well, remember what I just read you, including

1 the parenthetical, including producers are also handlers.

2 A. Yes.

3 Q. Let me ask how that statement comports -- which
4 you just made comports with the following, if this is what
5 you just said.

6 A. Yes.

7 Q. Were all that was intended, it seems hardly
8 necessary to have included the parenthesis since a handler
9 who purchased milk from other producers would clearly be
10 covered as a handler with respect to such milk, whether or
11 not he might be a producer/handler, with respect to milk of
12 his own production.

13 A. Yes. So what's the question?

14 Q. The more reasonable construction -- would you
15 agree or disagree with the following statement? The more
16 reasonable construction is that the parenthetical phrase
17 was meant to reach a producer/handler who handles or
18 distributes milk which he himself produces?

19 A. Better read it again.

20 Q. The more reasonable construction is that the
21 parenthetical phrase was meant to reach a producer/handler
22 who handles or distributes milk which he himself produces.

23 A. I suspect that's what they said, yes. I don't
24 necessarily agree with that, but.

25 Q. And if the Secretary has adopted the Court's

1 construction, notwithstanding your view, then in your own
2 testimony, a significant portion of your testimony has been
3 contradicted by the Courts and the Secretary.

4 A. But the fact is, as I understand, that the
5 Secretary has not adopted it. In the Pure Milk Decision,
6 you know, clearly indicates that.

7 Q. You keep calling that a decision. Was that a
8 decision, sir?

9 A. Well, I guess that's debatable.

10 Q. Debatable? How is it debatable, sir? It either
11 is a decision or it's not a decision.

12 A. Well, I would argue it's a decision. A statement
13 of policy.

14 Q. Do you understand the statements of policy must
15 be contained in final decisions?

16 A. Yes.

17 Q. Do you know whether the Pure Milk "Decision" was
18 a final decision?

19 A. No, I do not.

20 Q. Ahhh. Are you aware that there is a handler
21 known as Anderson Dairy in Minnesota --

22 MR. UNIDENTIFIED: (Inaudible.)

23 Q. (By Mr. English) I'm not aware of them.

24 A. If you didn't say it, I was going to.

25 Q. I can take my lumps. Are you aware of a

1 processor here in this marketing area, named Anderson
2 Dairy, that processes its own farm production, other than
3 these producer/handlers that you represent and pays for the
4 milk?

5 A. No, I'm not. I would certainly say he doesn't
6 pay for the milk. He may pay a tax, but he doesn't pay for
7 the milk. He produces the milk. How could he pay for it?
8 You know, pay for the milk that he produces?

9 Q. Yes, sir.

10 A. That doesn't make much sense. That's an
11 interesting use of terminology, why a producer pays for the
12 milk that a producer produces. It has to be developed by a
13 lawyer, in terms of terminology.

14 Q. And that's the same tax that you're saying would
15 be imposed on these producer/handlers then, if they get
16 regulated?

17 A. Absolutely.

18 Q. Going back to page five of your testimony, you
19 used the term equitable treatment and you say paren, not
20 equal treatment.

21 A. Yes.

22 Q. What is your definition of equitable, sir?

23 A. Equitable is treatment that leads to the same
24 basic end result in the marketplace, as far as the parties
25 are concerned.

1 Q. Is equitable the same thing as uniform?

2 A. Not necessarily, no.

3 Q. What's your definition of equal?

4 A. Equal is when everybody pays exactly the same
5 price.

6 Q. What's your definition of uniform?

7 A. Would be basically the same.

8 Q. You agree that equal and uniform are the same
9 thing?

10 A. Yeah.

11 Q. And you agree that the AMAA uses the word
12 uniform, but not the word equitable?

13 A. I agree, but the reports that have interpreted
14 them as advisor committees to the Secretary use the term
15 equity and, in fact, draw the distinction that I've drawn
16 here.

17 Q. But you haven't reviewed the Ideal Farms case and
18 Vance versus Freeman and Acme Brewers and can't say whether
19 the courts have agreed to that distinction?

20 A. No.

21 Q. Are you aware whether the word equal is a synonym
22 for the word equitable?

23 A. It's not in my terminology, that's for sure. It
24 may be in the thesaurus, but you know, the words mean
25 something different.

1 Q. So if it's in the thesaurus, it's sort of like
2 being on a court decision, it doesn't matter?

3 A. No, I didn't say that.

4 Q. Okay. Well, will you accept with me, sir, that
5 in Riget's II New Thesaurus Third Edition 1995, the very
6 first synonym for equitable is the word equal.

7 A. I believe you're right there.

8 Q. Did you review and you said you reviewed Dr.
9 Kyron's testimony, correct?

10 A. I certainly did, yes.

11 Q. Did you review any of the materials he referenced
12 in his testimony?

13 A. No, I don't think I did.

14 Q. So, for instance, he referenced something called
15 it's a May 1952 report from Kansas City, Missouri area, the
16 Early Development Milk Marketing Plans, Marketing Research
17 Report No. 14, you didn't review that?

18 A. I reviewed what he got out of that report, which
19 indicated that -- apparently indicated according to his
20 interpretation that milk market administrators could not
21 deal with the producer/handler issue, which I wonder about.

22 Q. But you didn't read it yourself.

23 A. No, I did not.

24 Q. You wondered about it enough to wonder about it,
25 but not enough to read the report.

1 A. Yes. Yes. I thought it was fairly incriminating
2 of milk market administrators to say that they couldn't
3 manage the situation.

4 Q. Did you read the affidavit of Herb Forest (phon.)
5 that Dr. Kyron referenced?

6 A. No, I did not.

7 Q. Did you wonder about the conclusions in that
8 affidavit?

9 A. Since I didn't read it --

10 Q. But you read Dr. Kyron's testimony, correct?

11 A. Right, right.

12 Q. Did it give you any instinct, perhaps, to go
13 investigate what was underlying in the form of that
14 affidavit?

15 A. No, it didn't. Let me tell you why.

16 Q. I didn't ask why, sir.

17 A. Okay.

18 Q. In the context of that 52 report and in the
19 context of the affidavit, neither of which you bothered to
20 read, would it surprise you then if the decision for New
21 Jersey and New York in 1957, that the Secretary in limiting
22 regulation, that is to say not fully regulating
23 producer/handlers said the following:

24 "That at the same time they are not sufficiently
25 large to constitute a serious competitive factor

1 in the marketing area."

2 A. I believe that, yes, if that's what they
3 concluded.

4 Q. And since you haven't read the testimony of Mr.
5 Murfield (phon.) or Mr. Kruger (phon.), you don't know
6 whether in the context of the Arizona market, that the
7 producer/handler is sufficiently to constitute a serious
8 competitive factor in the marketing area, do you?

9 A. I think I know enough about the market to
10 conclude that they're not.

11 Q. Well, I wrote down what you said you reviewed. I
12 don't recall saying that you reviewed the market
13 statistics. Did you read the market statistics?

14 A. Mr. Van Dam had in his testimony.

15 Q. That's the statistics you reviewed, right?

16 A. Yes.

17 Q. What other statistics did you review, other than
18 Mr. Van Dam's? Is that what you reviewed?

19 A. I reviewed the prices in the market.

20 Q. But when you say you're familiar enough with the
21 market, you're relying on the fact that you read Mr. Van
22 Dam's testimony, correct?

23 A. I know that there are certain distribution of
24 customers and certain distribution of processors in the
25 Phoenix market, that it's a highly concentrated market,

1 dominated by one processor and two vertically integrated
2 processors. And one --

3 Q. Go ahead.

4 A. -- small, relatively speaking small, producer
5 distributor.

6 Q. And you got that from reading Mr. Van Dam's
7 testimony?

8 A. No. No, I know that much about the market.

9 Q. Oh. Where'd you get that, sir?

10 A. I'm a dairy economist. I do know something about
11 markets.

12 Q. What material did you review to reach that
13 conclusion, since you didn't read either Mr. Murfield's
14 testimony or Mr. Kruger's testimony?

15 A. Mr. English I'm a dairy economist. I know
16 something about markets throughout the United States, and
17 I'm well aware of the processors that operate in these
18 markets. I know something about market shares, and so I
19 don't have to read a whole lot of testimony to draw
20 conclusions with respect to those issues.

21 Q. Did you study Exhibits 5 and 6 in this hearing?

22 A. Show me Exhibits 5 and 6 and I'll answer the
23 question as to whether I've seen them.

24 Q. Did you review the Market Administrator's
25 Statistics, Exhibits 5 and 6 for the two orders in this

1 proceeding?

2 A. No.

3 Q. No, sir?

4 A. No.

5 Q. Did you review any of the examination, either
6 direct by the government, or cross-examination the counsel
7 in this room of the Market Administrator witnesses
8 regarding that Exhibit 5 and 6 that you never read?

9 A. No, I did not, but I'd like to see Exhibits 5 and
10 6 to see if I've seen them.

11 MR. ENGLISH: May I approach?

12 THE COURT: You may.

13 THE WITNESS: No, I haven't seen these.

14 Q. (By Mr. English) Thank you, sir.

15 In Exhibit 43, page 24 --

16 THE COURT: If you'll --

17 Q. (By Mr. English) Exhibit 43, his dairy --

18 A. I better have a copy up here of the resume.

19 MR. UNIDENTIFIED: I'll give him mine for now.

20 THE COURT: Thank you.

21 THE WITNESS: Page what?

22 Q. (By Mr. English) 24.

23 A. Okay.

24 Q. First, if you've listed one of these numerous
25 documents that you've been involved in, what does that mean

1 exactly? For instance, the kind of materials that are here
2 on 24, which are --

3 A. If I'm listed first on it, I am the major author.

4 Q. Okay.

5 A. Of that article. If I am listed in another
6 position on it, I had some involvement in that publication.
7 But variable, depending upon the publication.

8 Q. But would you review each of these if your name
9 appears on it?

10 A. I may have been involved with the whole thing,
11 but I may have been involved with just a part of it.

12 Q. If there were a portion of it with which you
13 disagreed, would you not have your name on it?

14 A. If there's a portion of it with which I disagree,
15 would I not have -- it depends on how strongly I disagree
16 with it.

17 Q. What's your policy about putting your name on
18 these documents that show up in your resume?

19 A. My policy is if I contribute to the article, I
20 allow my name to be put on it.

21 Q. Well, let me start with one that you don't have
22 your name in the first position. The second one on page
23 24, the May 1997 paper titled, Envisioning Deregulated
24 Dairy Industry paper 97-1.

25 A. Right.

1 Q. Do you remember that document?

2 A. Oh, yes.

3 Q. Do you remember there was a discussion of what
4 would happen if federal orders went away?

5 A. Oh, yes. Yes. Yes.

6 Q. Do you remember a paragraph entitled number two,
7 no uniform pool blend prices? Do you remember that?

8 A. Well, if you were to ask me, can I regurgitate
9 what's in it, probably not, but go ahead.

10 Q. Well, let me ask, if I may, see if this will
11 refresh your recollection of what's in that paragraph.

12 A primary equity function performed by FFMOs is
13 to guarantee the milk producer will receive the same
14 minimum price regardless of the identify of the processor
15 buying that producer's milk. This market-wide pooling
16 function will cease upon the elimination of FFMOs.

17 A. That's a true statement, that it will cease.

18 Q. Is the rest of it true?

19 A. The rest of it?

20 Q. What I read, do you want me to read it again?

21 A. Yes.

22 Q. A primary equity function performed by FFMOs is
23 to guarantee that a milk producer will receive the same
24 minimum price, regardless of the identity of the processor
25 buying that processor's milk.

1 A. It says a milk producer buying the processor's
2 milk, I agree with that. Producer/handler do not buy milk
3 though.

4 Q. Unless the courts have said otherwise, right?

5 A. Unless says what?

6 Q. Unless the courts have said otherwise, right?

7 A. Well, you know, courts can be wrong, too.

8 Q. But otherwise, you agree with the statement?

9 A. Well, it doesn't say anything about
10 producer/handlers.

11 Q. That wasn't the point. Do you want me to read it
12 a third time and ask --

13 A. No, I agree with the statement otherwise.

14 Q. So in that instance, this paper which you are --
15 so, in other words, you agree with that statement and adopt
16 it as your own?

17 A. Yes, in the context of producers, yes, but not in
18 the context of producer/handlers, because it says nothing
19 about producer/handlers.

20 Q. But nonetheless, in that instance, the word
21 equity and same have been equated and you agree with it,
22 correct?

23 A. I don't have any problem with the statement.

24 Q. Okay. Let me go next to the one that you're a
25 primary author on. Two down, it's not a crossword puzzle,

1 I'm sorry.

2 An economic evaluation of basic form of the price
3 EFP alternatives, AFPC working paper 97 2, June 1997; do
4 you remember that?

5 A. I do, yes. It's a university study committee
6 report.

7 Q. Do you agree, sir, that if classified pricing is
8 to be sustainable, it must be uniformly applied?

9 A. Oh, yeah. Yeah. It is uniformly applied.

10 Q. Skip to one I amazingly can't find on your list.
11 This is AFPC issue paper 021, November 2002, Fostering a
12 Dynamic Dairy Industry and yours is the only name that
13 appears on it.

14 A. That's quite possibly not on here.

15 Q. Do you recollect that?

16 A. Oh, yes.

17 Q. Do you recall saying that other decisions have
18 been made that favor particular segments of the industry to
19 the detriment of others?

20 A. I'd have to look at the context of it.

21 Q. Do you recall saying --

22 A. I believe that to be the case, that there are
23 decisions that have been made to the detriment of others
24 and --

25 Q. And that are in favor of one --

1 A. Let me give you a specific.

2 Q. Okay.

3 A. And I suspect that this is what that refers to,
4 if you'd let me see it, I could verify it.

5 But I would suspect it refers to the Class Three
6 and Class Four pricing issue and the higher of issue where
7 the chief plants benefit to the detriment of others in the
8 industry. I suspect it relates to that whole topic.

9 Q. But that's one example. You agree there's other
10 examples, correct?

11 A. Oh, yeah, there may be other examples, yeah.

12 Q. And do you recall then saying, as explained,
13 subsequently, the longer such provisions remain in place,
14 the greater the distortions created and more difficult it
15 is to remedy the regulatory mistakes.

16 A. Absolutely, absolutely.

17 Q. This is certainly not your federal order
18 proceeding, correct, sir?

19 A. That's right.

20 Q. You testified back in 1990 at a proceeding that
21 makes us appear like a brief instant in time, known as the
22 national hearing. Do you recall testifying in the fifth
23 segment of that proceeding in October of 1990 in Irving,
24 Texas?

25 A. I recall testifying in Irving, Texas, yes.

1 Q. Do you recall testifying for Hershey Foods?

2 A. Oh, yes.

3 Q. And the issue there was that Hershey Foods was
4 concerned that the classification for the milk it used to
5 produce chocolate crumb was different than the
6 classification for chocolate crumb made from non-fat dry
7 milk, correct?

8 A. Yes.

9 Q. And the reason for the concern was that Hershey,
10 because it was in a different class paid a different
11 minimum uniform price for the milk used to produce its
12 chocolate crumb than its competitors that used non-fat dry
13 milk to produce chocolate, correct?

14 A. Yep.

15 Q. And that put Hershey in a competitive
16 disadvantaged position, correct?

17 A. Yep.

18 Q. And that was, in your opinion, a disorderly
19 marketing condition.

20 A. Yeah, but they bought the product in that case.

21 Q. So it all comes down to that one distinction for
22 you that they bought the product, correct?

23 A. Well, it's a basic distinction in a vertically
24 integrated firm, it certainly is. I mean, there is
25 obviously no purchase of product in a vertically integrated

1 firm.

2 Q. But let me ask the question, sir. That's what it
3 comes down for you, that in your opinion, there is no
4 purchase of the product, correct?

5 A. Yes. Yes.

6 Q. If there's purchase of the product, then there
7 should be uniform treatment, correct?

8 A. If it was purchase of a product, you know, then I
9 could understand the reasoning, but I can't understand the
10 reasoning for imposing a tax on these guys and putting them
11 out of business.

12 MR. ENGLISH: I have no further questions.

13 EXAMINATION

14 BY MR. BERDE:

15 Q. Good afternoon, Dr. Knutson. My name is Sidney
16 Berde.

17 Dr. Knutson, does the term producer/handler
18 appear anywhere in the Act?

19 A. I'm not sure about that, Mr. Berde. Not a
20 hundred percent sure.

21 Q. Is a producer/handler a handler?

22 A. Oh, sure, that's why he's called a handler, and
23 also a producer.

24 Q. And does the Act regulate handlers?

25 A. Sure it does.

1 Q. Does the Act regulate or call anyone in the --
2 under the Act a producer/handler?

3 A. Again, I'm not sure if it does call anybody under
4 the Act a producer/handler.

5 Q. If a producer/handler is a handler, and they Act
6 specifically directs the Secretary to regulate all of the
7 handlers, how does it come about that the producer/handler,
8 who is a handler is exempt from any of the payment
9 requirements applicable to all other handlers?

10 A. Because they're a producer/handler and because
11 they do not buy milk.

12 Q. Because they do not buy milk.

13 A. Yeah.

14 Q. Are you familiar with the terms of the order that
15 defines a producer/handler?

16 A. Well, generally speaking.

17 Q. Are you aware that a producer/handler in order to
18 qualify as such, must deal only in his own farm production
19 except to the extent that he may purchase in a month
20 150,000 pounds?

21 A. I'm familiar, yeah.

22 Q. You're familiar with that?

23 A. Yeah, sure.

24 Q. If such a handler purchases a load of milk in
25 excess of 150,000 pounds, which would result in that

1 outside purchase constituting no more than one percent of
2 his total receipts of milk, are you aware that such a
3 producer/handler would become fully regulated with respect
4 to the remainder of his own milk?

5 A. That may be the case, yes.

6 Q. It may be the case?

7 A. Yeah.

8 Q. Has he purchased the milk in that case?

9 A. If he's bought -- for that portion of the milk
10 that he's bought, he's purchased it.

11 Q. No, I'm talking about his own milk.

12 A. For the (inaudible) he hasn't.

13 Q. Are you aware that the order regulates him fully
14 with respect to his own milk also?

15 A. Well, it may do that.

16 Q. Well, he hasn't purchased the milk, has he?

17 A. No, he hasn't.

18 Q. In your context of the word and in your
19 understanding of the word purchase. Has he acquired that
20 milk for marketing?

21 A. Has he acquired it? He's produced it.

22 Q. Has he acquired it for marketing.

23 A. He has produced it. It is in his ownership. He
24 has produced it from the start.

25 Q. Has his handler plant acquired that milk for

1 market?

2 A. You can't distinguish between, you know, the
3 producer and the handler and the producer/handler.

4 Q. I just want a question to the answer.

5 Has the handler plant acquired that milk for
6 marketing?

7 A. Acquired, you mean have control of it? Yes.

8 Q. Yes.

9 A. Yes, it has control of it.

10 Q. Are you aware that the courts have construed the
11 term purchased in that context to mean?

12 A. To mean what?

13 Q. To mean purchased.

14 A. No.

15 Q. You're not aware of that.

16 A. No.

17 Q. If the courts have so, in fact, construed the
18 term purchase to mean acquired for marketing in that
19 context --

20 MR. YALE: Objection, Your Honor, --

21 THE COURT: He hasn't even asked the question
22 yet. He's asked a half a question.

23 MR. YALE: I'm sorry, I'll let him finish the
24 question.

25 Q. (By Mr. Berde) If the courts have so construed

1 the term purchase in the context of that statutory
2 provision and the overall context of the order to mean,
3 acquired for marketing, does that change your conclusion,
4 as to whether he has purchased that milk?

5 THE COURT: You may make your objection.

6 MR. YALE: All right. Now, I'd like to.

7 THE COURT: And what's the basis of your
8 objection?

9 MR. YALE: The basis of the objection, Your
10 Honor, is it's an underlying assumption in this situation
11 that the law and the circuits and Supreme Court have
12 settled this issue (inaudible).

13 THE COURT: Well, he's saying if the law says
14 that.

15 MR. YALE: I understand. And the basis of my
16 second objection is, is that now we're starting to have a
17 discussion of the law as opposed to what the facts are.

18 MR. BERDE: This only arises as an issue because
19 this witness has presumed to pronounce what the law is by
20 stating --

21 THE COURT: I'm not sure that he's quite gone
22 that far, but I'll allow him to answer your question if the
23 law says what Mr. Berde says, whatever the rest of his
24 question was. I can't remember it. Do you remember it?

25 THE WITNESS: You better read it back.

1 THE COURT: We don't have that capability.

2 THE WITNESS: Okay. Restate the question.

3 Q. (By Mr. Berde) Are you aware that the courts in
4 three separate cases interpreting the Agricultural
5 Marketing Agreement Act have interpreted the term
6 purchased, as it appears in the Act to mean acquired for
7 marketing?

8 A. Purchased as acquired for marketing.

9 Q. Yes.

10 A. And I can believe that, but I don't know how it
11 related to producer/handler.

12 THE COURT: The question he asked you, are you
13 aware the courts have said that?

14 THE WITNESS: Yes, yes.

15 THE COURT: And I don't know if you know.

16 THE WITNESS: I wasn't, but I don't have any
17 problem with that.

18 Q. (By Mr. Berde) Well, perhaps I should add to my
19 question the fact that the courts have made that
20 interpretation in the context of a producer/handler issue.

21 A. Yeah, and I say I don't see how they could say
22 that the producer/handler has acquired the products since
23 it owns the product from the very start. It produces the
24 product.

25 THE COURT: You know, I think -- I would only

1 pursue this if you're going to go somewhere new that Mr.
2 English didn't already go on this particular issue.

3 Q. (By Mr. Berde) Well, you're not suggesting that
4 we should reject the court's interpretation and accept
5 yours, are you?

6 A. I'm suggesting that we ought to review the
7 court's interpretation, which I think that's part of what
8 this hearing is all about, is it not?

9 Q. Well, --

10 A. I mean, we've had a policy of exempting
11 producer/handlers, now we want to put a restriction on
12 them. This is what this hearing is all about, it seems to
13 me.

14 Q. Well, attempts have been made to review that
15 decision and the Supreme Court has denied them. Where do
16 we go from there?

17 A. Well, we make a decision in this case and pursue
18 it from there.

19 Q. Are you also aware for the last 50 years, the
20 Secretary has reiterated in decision and decision, that he
21 has full power and authority to regulate fully
22 producer/handlers.

23 A. I understand that's been said, yes.

24 Q. I don't --

25 A. I understand that that has been said, yes.

1 Q. Now, there was some discussion in your testimony
2 concerning the word orderly marketing and what constitutes
3 disorder.

4 A. Yes. Yes.

5 Q. Would you agree that what constitutes orderly
6 marketing and the context of the order system, is a
7 determination that is committed to the sound discretion of
8 the Secretary?

9 A. Oh, yes. Yes. I'm familiar with the fact that
10 the Secretary makes that decision.

11 Q. And it's his consideration and his definition
12 that must control, rather than yours.

13 A. Her today.

14 Q. I beg your pardon?

15 A. Her today.

16 Q. I'm sorry, I -- yeah, we must be politically
17 correct, yes, yes. Her, yes. You would agree to that?

18 A. Yes.

19 Q. Okay. And you also made a reference to the Texas
20 decision involving Pure Milk, do you recall that?

21 A. Yes.

22 Q. As somehow having rejected the notion that
23 producer/handlers are subject the regulatory powers of the
24 Secretary in terms of payment of uniform prices, et cetera,
25 do you recall that?

1 A. Yes.

2 Q. I'd like to read you a portion of that decision
3 and ask you what portions you agree or disagree with. I'll
4 quote:

5 "Any time that milk is sold within the federal
6 order marketing area, and such milk is not priced
7 by the order, the ability of the order to
8 maintain orderly and stable marketing conditions
9 for milk may be impaired."

10 Do you agree with that?

11 A. Read the statement again.

12 Q. "Any time that milk is sold within the federal
13 order marketing area, and such milk is not priced
14 by the order, the ability of the order to
15 maintain orderly and stable marketing conditions
16 for milk may be impaired."

17 A. Oh, it may be. You know, I don't have any
18 problem with it.

19 Q. It may be impaired.

20 A. It may be. It doesn't attach any probability to
21 it.

22 Q. And at what point may it be impaired, in your
23 opinion?

24 A. If it becomes so large that the end result is
25 chaos in that market.

1 Q. Yes. And at what --

2 A. Oh, I don't think you can -- if you're saying
3 what percentage. I don't think you can state any
4 percentage. You look at the results in that market and ask
5 the question, you know, is there chaos and that requires
6 something other than switching accounts.

7 Q. Well, what do you mean by chaos?

8 A. The market is completely disrupted, you know.
9 You know, you've got price wars in the market. You've got
10 --

11 Q. Price wars among whom?

12 A. Among processors, between processors and
13 producer/handlers, you know. That's -- that to me, you
14 know, but you'd have to prove. You'd have to prove the
15 results.

16 Q. And if one segment of the market, one segment of
17 the handlers are required to pay order prices, and one
18 segment is not, could that give rise to the kind of chaos
19 you're describing?

20 A. It -- I don't deny that it could, but what is the
21 probability, and then has it. Has it in Phoenix and --

22 Q. But it could.

23 A. Oh, it could, sure. A lot of things could
24 happen.

25 THE COURT: This might go faster if you confine

1 your answers to his questions.

2 Q. (By Mr. Berde) I'll go on and quote again from
3 that decision.

4 A. Yes.

5 Q. Quote:

6 "When milk of a producer/handler is sold in a
7 federal milk marketing area, such milk is not
8 priced by the order. In such a case, the order
9 does not provide uniform regulated pricing among
10 competing handlers, since fully regulated
11 handlers must pay the minimum order Class One
12 price for milk in fluid uses, while
13 producer/handlers are not required to do so."

14 Do you understand that's the case?

15 A. I understand what they're saying, yes.

16 Q. You agree with that?

17 A. I understand what they're saying, yes.

18 Q. Well, do you understand that producer/handlers to
19 the extent that they're totally exempt from the pricing
20 provisions of the order do not pay the uniform prices
21 called for by the Act?

22 A. Yes.

23 Q. Quoting again:

24 "This raises the potential for competitive
25 inequities among handlers. Furthermore, there is

1 not an equal sharing among all dairy farmers in
2 the market of the returns from the sale of all
3 milk -- in the sale of all milk in all uses since
4 producers whose milk is being priced under the
5 order do not share in the Class One sales of
6 producer/handlers."

7 You understand that to be true?

8 A. I understand.

9 Q. Yeah.

10 A. That it says -- it reaches -- it raises the
11 potential. The question is, you know, has that potential
12 been realized.

13 Q. Now, if a producer/handler's share of a regulated
14 market were to arise to the level of let's say 20, 25
15 percent of the total Class One sales in the market, do you
16 anticipate that such a level of competitive advantage that
17 such a producer/handler would have, might cause quote,
18 disruptive or price cutting or anti-competitive types of
19 conduct in that market?

20 A. Well, I've got two problems with that. The
21 notion of competitive advantage is not clear to me to start
22 with. That's clear enough and that's clear enough for my
23 testimony, that that is at issue.

24 Secondly, you've got to look at the structure of
25 the market. I mean market orders in my view were designed

1 to foster competition. I mean, that's -- they weren't
2 designed to stifle competition. And if they -- you know,
3 if you've got a market which is extremely highly
4 concentrated, which the market that you're -- I presume
5 you're eluding to is, with predominance of cooperative, a
6 very large independent, two vertically integrative
7 retailers, that's a market that absolutely calls for more
8 competition in that market. And I would argue that the
9 basis, the very basis for the producer/handler exemption is
10 one because it is producers that you're talking about here.
11 It is farmers, who have taken on the risk of becoming
12 handlers, and that leads to the issue of do they have a
13 competitive advantage or not in that marketplace.

14 They operate as a producer and they operate as a
15 handler. They don't have a whole lot of specialized people
16 that are educated at the bachelor's degree or above to
17 handle individual functions in their operation. You know,
18 you've got to believe that the producer/handler exemption
19 evolved from the very notion that a producer should have
20 the ability to engage in both of these functions, and be a
21 competitive force in the marketplace.

22 Q. Where do you find in the history of the Act or in
23 any pronouncements of the Secretary, or in any decisions of
24 the Secretary, or in any policies of the Secretary the
25 notion that a producer/handler should be given a price

1 benefit to enable him to be a competitive factor in the
2 market?

3 A. Historically. We've historically allowed him to
4 do that.

5 Q. I asked where do you find in the history of the
6 Act, or in the Secretary's pronouncements, or decisions
7 with respect to the exemption of producer/handlers the
8 notion that producer/handlers should be permitted to be
9 competitive factors, to the extent that they impose a
10 competitive impact in the market and other handlers, where
11 do you find that?

12 A. Well, I would certainly think that the very basis
13 for the producer/handlers --

14 Q. I'm not asking you what you think. I'm asking
15 you where you find --

16 A. I do not --

17 THE COURT: Let him answer, Mr. Berde.

18 MR. YALE: He needs to let him answer before he
19 interrupts him.

20 THE COURT: Yeah.

21 Q. (By Mr. Berde) I don't want your opinion about
22 it. I want to know --

23 MR. YALE: Objection. He's still trying to
24 answer the question.

25 THE COURT: Okay.

1 MR. YALE: He was trying to answer the question,
2 let him try to answer the question.

3 THE COURT: He got six words into his answer.
4 Try to answer the question that Mr. Berde poses to you.

5 THE WITNESS: I don't find it in the Secretary's
6 opinion. I do find in the advice given to the Secretary by
7 advisory committees that they foster competition among
8 producers and handlers, while encouraging the establishment
9 of reliable channels of trade. That's what these advisory
10 committees that were set up for the Secretary, to advise
11 the Secretary to do.

12 You know, to foster competition in the
13 marketplace. And if the role of federal orders is to
14 create monopoly, then federal orders are not long for the
15 future.

16 Q. (By Mr. Berde) Are you aware that the Secretary
17 has stated in enumerable decisions at the judicial officer
18 level and in federal order decisions regulating various
19 markets, that producer/handlers are entitled to exemption
20 only to the extent that they constitute a diminimous impact
21 in terms of competition in the marketplace?

22 A. I'm familiar with that fact.

23 Q. You're familiar with that fact?

24 A. Yes. Yes.

25 Q. Do you believe that in the Arizona market that

1 producer/handlers presence in that market constitutes a
2 diminimous impact in competition in that market?

3 A. It certainly doesn't constitute disorderly
4 marketing.

5 Q. Would you answer my question?

6 A. Well, I'm not sure exactly what it's market share
7 is in that market, but there's no evidence of disorderly
8 marketing in that market.

9 Q. Well, let me get to what your testimony has to
10 say about the Arizona market.

11 At the bottom of page three, you state:

12 "It is important to note that the minimum sized
13 plants studied by the Cornell scientists were
14 nearly four times or three million pound
15 threshold proposed to be subjected to Class One
16 pricing and pooling regulations in Federal Order
17 124 and Federal Order 131. The minimum size of
18 plants studied by Cornell was approximately the
19 size of the largest producer/handler plant, on
20 whose behalf my study and this testimony was
21 developed."

22 A. Exactly. Yes.

23 Q. What is the size of the largest producer/handler
24 plant that you studied in the Arizona market?

25 A. Oh, I can't tell you that. I mean, that's

1 confidential information.

2 Q. How do you know whether it's three times, four
3 times, two times the size of the Cornell study?

4 A. I have the information and I say that it's
5 approximately the size that -- the statement stands for
6 what it says.

7 Q. What do you mean by approximately the size?

8 A. Oh, within two or three million pounds a month.

9 Q. Within two or three million pounds -- 12 million
10 pounds?

11 A. No, no, no. The minimum sized plant studied by
12 Cornell, Mr. Berde, was four million pounds a month.

13 Q. Was four million pounds.

14 A. Excuse me, it was 20 million pounds a month, I'm
15 sorry.

16 Q. 20 million pounds.

17 A. Yes. Yes.

18 Q. And the plant that you studied in Arizona was
19 within what?

20 A. Oh, within three to four million pounds of that.

21 Q. And what do you know about the competitive end
22 roads that that Airsairs (phon.) farms plant has made in
23 that market?

24 A. Well, I'm aware that they have the business of
25 Costco and Sam's in that market.

1 Q. Any other?

2 A. Yeah, they have some business in a major chain in
3 that market.

4 Q. Yeah. How many?

5 A. That serves primarily low income consumers.

6 Q. What share of the Class One sales do they have in
7 that market?

8 A. I do not know the answer to that question.

9 Q. Do you know when that plant started in operation?

10 A. Well, I don't recall exactly the year it started
11 in operation.

12 Q. Do you know how many years it has been in
13 operation?

14 A. It's been in operation for a number of years.

15 Q. How long?

16 A. A decade or so.

17 Q. Do you know what -- at what level of Class One
18 sales in the marketing area it started with?

19 A. Oh, like most farms, I presume it started with a
20 small share. I mean, that's to be expected.

21 Q. One million, half a million, 300,000?

22 A. I presume it started at zero.

23 Q. Yeah. Then do you know how rapidly it has grown?

24 A. Well, I know it's growing rapidly after the
25 reform movement.

1 Q. I beg your pardon?

2 A. After the reform of federal orders, it grew
3 rapidly.

4 Q. What difference would reform have made?

5 A. Oh, higher pricing.

6 Q. What?

7 A. I mean, a higher of pricing, Mr. Berde.

8 Q. A higher of. Do you know what is the price Class
9 One differential in that order was dropped as a result of
10 the reform?

11 A. Yeah, but it also installed higher of pricing,
12 Mr. Berde.

13 Q. So what?

14 A. Well, it makes a lot of difference, because there
15 was a big differential than there is today, a big
16 differential between the Class Three and the Class Four
17 price. You put in higher of pricing and then you jack up
18 that Class One price even more, and that stimulates
19 production. It drives down the blend price in the market
20 and so it's the reform movement itself that has created the
21 loophole that Mr. Holland talks about.

22 Q. And you think it's because or we can consider
23 that the rapid rise or the rapid growth of a
24 producer/handler in the Arizona market is attributable to
25 the higher of, in terms of pricing Class One milk?

1 A. Certainly a big factor. Certainly a big factor.

2 Q. And the fact that the handler is relieved of the
3 payment between blend and One, that every other handler has
4 to pay in that market, has nothing to do with the rise of
5 his insurgence into that market?

6 A. No. I think the primary factor in it is that
7 we've expanded, you know, the -- well, there's two primary
8 factors. First of all, Sam's and Costco have become major
9 forces in that market for selling milk. They are a niche
10 that producer/handlers are perfect to serve, absolutely
11 perfect to serve. And the reason they're absolutely
12 perfect to serve, is because they sell a limited line of
13 milk.

14 So they are a perfect market niche for
15 producer/handlers. So you combine federal market order
16 reform with the rise of Sam's and Costco, and you've got a
17 perfect environment for a producer/handler to expand
18 production. And I might say, that expansion has been a
19 positive factor in that marketplace, in terms of
20 competition. A badly needed positive factor.

21 Q. Are you aware that a regulated handler in the
22 market is equally capable of supplying that niche in the
23 market?

24 A. Oh, sure, sure, and you could drive the
25 producer/handler out of the market and give that handler a

1 monopoly position in the market, along with Safeway and
2 Kroger.

3 Q. And so your justification for the continued
4 exemption of a major competitive factor in the market
5 operating as a producer/handler exempt from payment of
6 class prices, is because you want the enhanced competition
7 to market; is that it?

8 A. It certainly should be, yes. It certainly ought
9 to be consideration by the Secretary.

10 Q. And notwithstanding that that is precisely
11 contrary to what the Secretary has stated as the basis for
12 exempting a producer/handler and, in fact, has stated when
13 such a producer/handler becomes a competitive factor, he
14 should be regulated.

15 A. Yeah and put out of business, that's what the
16 Secretary says, right?

17 Q. No. He said they should be regulated.

18 A. Yeah, and in my discussions, Mr. Berde, with
19 producer/handlers say, you know, you preimpose this
20 regulation on me and I don't become a competitive factor in
21 the marketplace anymore.

22 Q. Now, tell me why if the large producer/handler
23 becomes regulated he would be put out of business?

24 A. Because, as I said earlier, the producer has
25 taken on the function and the risks associated with being

1 both a producer and a handler. Now, you'll notice that
2 Dean's or Kroger or Safeway have not done that. They have
3 not taken on the risk of being a producer. Why? Because
4 it's a heck of a lot more complex.

5 You know, you can talk about, you know,
6 competitive advantage, but you put yourself in the position
7 of a producer, who takes on the extra risk of becoming a
8 handler, competing with Dean's, Safeway and what's your
9 reaction to that situation? You're going to say, you're
10 going to tax this guy and put him out of business? Now,
11 that doesn't make much sense as a matter of public policy,
12 does it?

13 Q. My question was, what is there in the regulation
14 of the handler of a producer/handler to put him on the same
15 playing field with regulated handlers that would put him
16 out of business?

17 A. Because you would impose a tax on him that would
18 take away his ability to be competitive in the marketplace.

19 Q. Is that same tax that's imposed on Safeway?

20 A. A tax imposed on Safeway.

21 Q. Or (inaudible).

22 A. They buy the milk. He doesn't buy any milk.

23 Q. Oh, are we going to (inaudible) that again?

24 A. Sure.

25 Q. Well, let's assume that the courts have ruled

1 against you on that issue and that he does buy the milk,
2 what is your answer then?

3 A. And I say he has no competitive advantage in the
4 marketplace. If they had a tremendous competitive
5 advantages in the marketplace, Mr. Berde, you would see
6 producer/handlers all over the country. And you would see
7 them expanding. I mean, this is a capitalistic system.
8 The producers are smart. And I can understand why Safeway
9 and Kroger and Dean's and all of the other companies want
10 to do away with producer/handlers, why they want to do away
11 with the competition, I can understand that.

12 But I can't understand why the Secretary would
13 want to do that under Federal Milk Marketing Orders. That
14 is beyond my comprehension.

15 MR. BERDE: Thank you, Your Honor.

16 THE COURT: Thank you. I think this is a good
17 time for a short break.

18 (A break was held.)

19 THE COURT: Okay. We're back on the record, and
20 Mr. Beshore, you have the floor.

21 MR. BESHORE: Yes, thank you, Your Honor. Marvin
22 Beshore for Dairy Farmers of America.

23 EXAMINATION

24 BY MR. BESHORE:

25 Q. Good afternoon, Dr. Knutson.

1 Is it your view, Dr. Knutson, that the Secretary
2 does not have the authority to regulate the minimum price
3 of milk used by a handler, when it's acquired from the
4 handler's own farm?

5 A. Yeah, I would say the answer is yes to that
6 question, simply because they don't buy the product.

7 Q. Okay. If they buy it from a separate legal
8 entity, then in your view, there's the --

9 A. Yes.

10 Q. -- authority to regulate?

11 A. Yes.

12 Q. And the right to regulate it?

13 A. Yes, for milk purchased.

14 Q. And it ought to be regulated just like any other
15 producer?

16 A. No, I'm not sure it ought to be regulated, with
17 respect to the milk that they produce themselves. I mean,
18 I think that's an interesting problem. It's one that is
19 not relevant to this case -- to this particular hearing, I
20 gather. But, you know, why you would regulate them with
21 respect to everything is beyond me. You know, unless, you
22 know, the proportion they produce is insignificant, I
23 suppose.

24 Q. But if they purchased milk from a separate legal
25 entity, then it ought to be regulated in the same fashion?

1 A. Separate -- a separate legal entity that they --
2 yeah. If you truly mean a separate legal entity that
3 they're not involved with in any way, I agree.

4 Q. Well, what if a handler acquires from a family
5 partnership milk for its use, should that be regulated?

6 A. A handler acquires from a family partnership,
7 acquires, you mean buys?

8 Q. Yes.

9 A. Oh, you know, if they buy. If there's a
10 purchase, I don't have any problem with regulation, I mean,
11 you know. But it seems to me you've got to have that
12 critical purchase.

13 You know, an integrative firm is exactly an
14 integrative firm. It's one that producers and it one that
15 markets, and you have an extremely difficult time
16 separating one function from the other in an integrative
17 firm.

18 Q. Okay. And by integrated, you mean on all
19 functions under one legal operation.

20 A. Yeah, under one legal entity, right.

21 Q. Okay. Now, are you basically supportive of the
22 current system, with respect to producer/handler regulation
23 throughout the federal order system?

24 A. Yes.

25 Q. Okay. And are you aware that in various

1 locations or assume with me for a moment, that in various
2 locations throughout the federal order system, handlers
3 acquire for marketing from farms that they own, the handler
4 owns, portions of their own milk supply and it's fully
5 regulated.

6 A. Sure, sure.

7 Q. And you don't have any problem with that?

8 A. I -- well, --

9 Q. It's part of the current system.

10 A. You know, the question is, you know, what's the
11 dividing line. And you know where the amount of purchases
12 are very small, then you know, it's clear enough to me that
13 you don't -- there's -- this firm has really taken on an
14 extraordinary task of performing both the functions of
15 production and the functions of marketing and in a single
16 operation.

17 And it seems to me that that was the purpose
18 behind the exemption and has been all the time, the purpose
19 behind the exemption.

20 Q. Okay. Now, what if a handler -- let's say the
21 handler has seven million pounds of Class One usage, and it
22 has its own farm, same ownership, and it produces about
23 five million pounds and it buys the rest from the pool.
24 What portion of that should be regulated?

25 A. Well, my view would be that just the two million

1 pound difference should be regulated, that would be my
2 view.

3 Q. Okay. And then the handler would then allocate
4 all of its own milk to Class One and have the pool
5 producers balance its utilization through the blend price,
6 correct?

7 A. Well, you know, it depends on what you mean by
8 balancing, when it comes right down to it. I'm familiar
9 with, you know, that issue of balancing. I think -- you
10 know, you present a particular case that I don't think is
11 relevant here, as far as this particular hearing is
12 concerned.

13 And so, you know, I'm convinced in my discussions
14 with these producers that they bear a substantial share of
15 the costs associated with the balancing function, and
16 they've -- you know, you look at the coops for example,
17 paying \$1.50 less than the lower of, or \$2 less than the
18 lower of for milk sold to them. That would seem to me to
19 be a rather exorbitant proposition, and one that I've seen
20 very little testimony with respect to in this hearing.

21 Q. Are you providing information with respect to
22 that for this hearing?

23 A. No, I'm just saying that, you know, that's my
24 understanding that we see substantially lower prices on the
25 milk that's sold to the coops.

1 Q. Did you investigate the volumes involved with
2 that?

3 A. No, I did not.

4 Q. Okay. What if -- you're saying that the
5 hypothetical I gave you is not relevant to this proceeding,
6 but what if the record indicated that a fully regulated
7 handler in these markets was in substantially that
8 circumstance? Would it be on an equal playing field with
9 the producer/handlers? That is, it had five million pounds
10 of its own production, fully priced and regulated under the
11 order, and the remainder of its needs pooled or for pool
12 producers, that they were all fully priced and regulated?

13 A. Well, it might -- you know, I'd need to do some
14 study of the situation, but it might well be, because it --
15 the -- there might not be a disequilibrium between the two,
16 simply because the producer/handlers produce, you know,
17 virtually all of the milk themselves. But you really have
18 to look -- you really have to get inside the firm and look
19 the situation over and look at it, to determine if there's
20 a disequilibrium or not. But then the question is --

21 Q. I'm sorry.

22 A. -- you know, from the standpoint of --

23 Q. I'm sorry, Dr. Knutson, is that the answer to my
24 question --

25 A. Okay.

1 Q. -- that you're not sure until you study the firm
2 more whether there's a --

3 A. Yeah.

4 Q. Okay. Now, you've indicated that the higher of
5 Class One mover has had an effect on what's occurred I
6 think in the Phoenix market since 2000, correct?

7 A. In all markets.

8 Q. In your opinion. In your opinion.

9 A. In all markets.

10 Q. But in this instance, in this hearing, you've
11 particularly related those comments to the Phoenix market,
12 correct?

13 A. Yeah, because you've put one incentive on top of
14 another incentive.

15 Q. And the incentive is, that with the higher of
16 pricing, you have a greater difference between the blend
17 price and the Class One price in the market.

18 A. Yes, and my point is that that's been imposed by
19 producers on themselves, by producer organizations on
20 themselves.

21 Q. And the reason why that's made a difference is,
22 is that the unregulated producer/handler then has a greater
23 amount of not accountability for class prices to work with
24 in competing with the regulated handlers.

25 A. I can't deny that.

1 Q. Okay. Well, I didn't think you were, but I
2 wanted to make sure.

3 Okay. And, in fact, that difference is what
4 they've got to work with in terms of competing with
5 regulated handlers, basically the difference between Class
6 One price and the blend price.

7 A. Oh, that's certainly part of it, yes.

8 Q. Now, is it your general view, Dr. Knutson, that
9 with respect to small businesses that all small businesses
10 should have the same government regulations applicable to
11 them?

12 A. No, I don't -- all small business should have the
13 same regulations applicable to them. I think you can state
14 my philosophy that small businesses should be given
15 latitude to innovate. All businesses should be given
16 latitude to innovate. And that's an integral part of our
17 capitalistic system and it's been well demonstrated in
18 research the small business are the innovators in our
19 system.

20 Q. The innovations that have been provided by the
21 small businesses in the Arizona market, because of the
22 producer/handler exemption are what?

23 A. Oh, the innovation of combining the functions of
24 production and processing and --

25 Q. That's an innovation?

1 A. Oh, absolutely. And in an efficient manner, with
2 a small product line serving Costco and Sam's and serving
3 the chain that markets largely to Hispanic population.
4 That's an innovation. I mean, I've talked to people at
5 Kroger, for example, Mr. Beshore, and --

6 Q. Beshore.

7 A. Beshore, sorry. I've talked to them and I asked
8 them, do you have a program for marketing to small, to
9 disadvantaged producers, to Hispanics, and they say, well,
10 we really don't, how would you do that.

11 Q. Okay.

12 A. And, you know, here's a market niche that the
13 Sarah Farms has established and gone after it and been
14 competitive. And I -- you know, for --

15 Q. Is it -- excuse me.

16 A. -- federal order regulation to turn around and
17 zap that market niche, it would just be a serious, serious
18 error.

19 Q. Is it your testimony, Dr. Knutson, that there are
20 no fully regulated handlers in the federal order system
21 that have limited product lines providing products to
22 Costco and Sam's?

23 A. No, there are people that do, but this one is
24 specifically designed to serve them.

25 Q. Okay. Well, if other people are doing it, that's

1 not exactly an innovation, is it?

2 A. Oh, absolutely it's an innovation.

3 Q. Okay.

4 A. It certainly is an innovation.

5 Q. Okay. Now, the innovation in the Pacific
6 Northwest order is home delivery?

7 A. Oh, there's a lot of things in the Pacific
8 Northwest Order.

9 Q. Is that one of them?

10 A. Sure.

11 Q. That's an innovation?

12 A. You know, in today's context it certainly is to
13 develop a home delivered market in today's context. I
14 don't see Dean's doing that. I don't see other big
15 processors doing that.

16 Q. Do you --

17 A. That's innovation.

18 Q. Does innovation have a -- would that word mean
19 new?

20 A. Well, it's new in today's context and that is new
21 in today's context.

22 Q. Okay. Are you -- did you review Mr. Holland's
23 exhibits or just his testimony?

24 A. I guess I reviewed just his testimony when it
25 comes right down to it. I can't recall exactly.

1 Q. Are you aware that one-third of the fully
2 regulated handlers in the federal order system average
3 about 3.7 million pounds Class One sales per month, fully
4 one-third of all fully regulated handlers in --

5 A. Oh, I certainly am and those are the ones that
6 are going out of business.

7 Q. Going?

8 A. Going out of business, yeah.

9 Q. Tomorrow, next week.

10 A. Possibly. I mean, they've been going out of
11 business for a long time.

12 Q. And they're going to continue going out of
13 business.

14 A. And they're going to continue to go out of
15 business.

16 Q. Okay. And the second third, are you aware that
17 the middle one-third grouping of 7A plants in the full
18 federal order system average 11.4 million pounds of --

19 A. I believe that, too, and they're going down in
20 numbers.

21 Q. Okay. Are those --

22 A. They're being bought out by the big guys.

23 Q. Are those two-thirds of all fully regulated
24 handlers, are they small businesses for the most part?

25 A. Well, I'd have to think. Yeah, for the most part

1 probably, yeah.

2 Q. Should the small businesses that you're speaking
3 on behalf of and those 200 -- 185 or 6 small businesses in
4 the system have the same regulations?

5 A. No, I would not --

6 Q. Be subject to the same regulations?

7 A. No, I would not argue that to, you know, simply
8 because they're not the same. These guys are producers and
9 they're handlers. They're different.

10 Q. Should --

11 A. They're not buying any milk.

12 Q. Should all those small business dairy processing
13 plants be subject to the same minimum wage laws?

14 A. No, they shouldn't.

15 Q. They should not be subject to the same minimum
16 wage laws?

17 A. Minimum wage -- oh, a minimum wage.

18 Q. Yes.

19 A. You mean the federal minimum wage?

20 Q. Yes.

21 A. Well, you know, I think it's pretty irrelevant as
22 far as this hearing is concerned.

23 Q. Well, regardless of what you think about its
24 relevancy, should they be subject to the same minimum wage
25 laws?

1 A. Yeah, I guess everybody should be subject to the
2 same minimum wage laws.

3 Q. How about the same laws with respect to hiring
4 alien labor?

5 A. Sure.

6 Q. How about the same laws with respect to
7 environmental regulations?

8 A. Sure.

9 Q. Same laws with respect to OSHA regulations?

10 A. Yeah, sure.

11 Q. How about the same laws with respect to worker's
12 compensation laws?

13 A. Yeah, they probably are.

14 Q. The same laws -- in fact, should they be subject
15 generally to all the same laws, except minimum federal
16 order milk prices?

17 A. And the answer is yes, you know.

18 Q. Okay. Now, you have used the word tax. I was
19 keeping track of it, and I got -- ran off the page.

20 It's your view in your testimony that if the
21 proposals that would establish a three million pound cap on
22 producer/handlers were adopted, that it would impose a tax
23 upon the producer/handlers that would be affected?

24 A. Yes.

25 Q. Okay. And you're -- I take it you're not using

1 that word tax in any legal sense, in that testimony?

2 A. Well, it's a very interesting issue.

3 Q. Well, are you or aren't you using --

4 A. No, no. No.

5 Q. Just a rhetorical sense?

6 A. Well, it's rhetorical in a sense, but it is, you
7 know, what everybody would understand I think, to be a tax.
8 They don't buy it, so you know, you've taxed them.

9 Q. Okay. Well, the handlers who are paying
10 throughout the system that have farms, the fully regulated
11 handlers now who have farms, who must account -- forget the
12 word pay -- account to the pool for their minimum class
13 price utilization on all their production are presently
14 accounting for those values on all their own milk
15 production, you understand that?

16 A. Oh, yeah.

17 Q. Yeah. And is it your -- as far as you're
18 concerned, that's a tax on that.

19 A. Sure. It is as far as their own milk production
20 is concerned.

21 Q. Okay. You have stated that one of the elements
22 of disorderliness in a market would be if there's a price
23 war.

24 A. Oh, yeah. Yeah. That's certainly one symptom of
25 disorderliness, yes.

1 Q. Okay. Is one symptom of a price war the sale of
2 products of -- at below cost?

3 A. I don't know if a price war is sales below cost.
4 You know, I don't think that you can draw that kind of a
5 synonymous. But then again, what is below cost in the case
6 of a producer/handler is also an interesting issue.

7 Q. How would you know a price war if you saw it?

8 A. Oh, I can --

9 Q. How --

10 A. I've seen plenty of price wars in milk markets
11 and I've seen plenty of price wars in gasoline stations. I
12 mean, they're basically the same concept, where you know,
13 you get vigorous price cutting back and forth across the
14 market.

15 Q. Have you ever seen --

16 A. And it has the effect of forcing down producer
17 prices as well in the marketplace.

18 Q. Have you ever seen a price war with respect to
19 finished products, marketed by fluid milk plants in a
20 federal milk market order?

21 A. Oh, yes. I studied them in my Ph.D.
22 dissertation.

23 Q. In a regulated federal milk market order?

24 A. Oh, absolutely, yes.

25 Q. And your Ph.D. was done when?

1 A. Oh, geez. 1967 when I completed it.

2 Q. Yeah and --

3 A. Price wars were pretty common at that time.

4 Q. In the federally regulated milk market orders?

5 A. Oh, yeah. Yes.

6 Q. And have you ever seen one since then?

7 A. Oh, yes, but they're less common today because of
8 increase concentration I talked about. Considerably less
9 common.

10 Q. Have you seen any since your Ph.D. dissertation
11 in federally regulated milk markets?

12 A. Well, I'm sure I have, but I can't recall. I
13 can't give you a specific example of them.

14 Q. Now, you have made some comments about the
15 testimony of some of the other witnesses that have come
16 before you. And with respect to Mr. Holland, I gather your
17 comments were made without the benefit of the exhibits
18 which he submitted with his testimony.

19 A. I think that's probably right, yes.

20 Q. So that when you said on point three at page ten,
21 data on current producer/handler numbers of volume were set
22 forth where USDA -- there are no such -- that no such
23 reliable data exists. You didn't have the benefit of the
24 information which Mr. Holland presented from USDA sources
25 in his exhibits?

1 A. Well, no, I was told by Mr. Roark (phon.). I
2 specifically visited with Mr. Roark and he told me that no
3 such data exists. And so -- I mean, he said that there's a
4 mixture of producer/handler --

5 Q. Okay.

6 A. -- regulated data on numbers, and non-
7 producer/handlers numbers, and he said to me that no such
8 current data exists. The furthest they go is 1999. And he
9 said when federal order reform came along, they quit.

10 Now, an individual market, you can gather it from
11 market administrators and individual markets, but in terms
12 of putting it all together, and seeing what the trend is
13 nationally, you know, which you can't do.

14 Q. Okay. You're -- I take it that what you were
15 told by Mr. Roark and the basis for your testimony, is that
16 particular publications that were done by USDA up to 1999
17 have not been done since.

18 A. That's right.

19 Q. Okay. But you didn't look at or analyze or have
20 the benefit of the data which Mr. Holland collected from
21 the Federal Market Administrators, and summarized in his
22 exhibits, when you made your comments about that?

23 A. No. I read, you know, what he had to say, and as
24 I interpreted what he had to say, it was that even his
25 numbers were not complete.

1 Q. Okay. Now, the top -- toward the top of page 11,
2 you have made the assertion that estimates were made by Mr.
3 Holland of the number of stores served by PHs, based on
4 incomplete and therefore unreliable data.

5 Now, what incomplete and unreliable data are you
6 referring to there? The IRI study?

7 A. Yeah. There wasn't complete data on all of the
8 stores. You know, all sizes of stores.

9 Q. Are you saying it was incomplete within what it
10 purported to be?

11 A. No. I'm saying it's incomplete -- well, yeah. I
12 mean, it is because it didn't include all of the volumes
13 and therefore, it's incomplete.

14 Q. In other words, because the data only represented
15 what it said -- what it purported to represent, but not the
16 entire universe, that it was incomplete because the rest --
17 because what it didn't purport to represent wasn't
18 included?

19 A. Exactly.

20 Q. That's your definition of incomplete?

21 A. Yes. Yes. Absolutely.

22 Q. Now, you have also commented on page 13 on point
23 number one with respect to Mr. Holland's testimony that no
24 data was presented on the prices producer/handlers received
25 for Class One milk that is purchased or surplus milk that

1 is sold. Instead Mr. Holland assumed that the federal
2 order prices prevail.

3 What are you referring to there? His
4 calculations of what their pool value might be if they had
5 ten percent surplus milk?

6 A. Well, no, what they got for the surplus milk.
7 What they purchasers or handlers, in fact, received.

8 Q. But he never said that he knew, because nobody
9 will tell us what they received, did he?

10 A. Well, that's true. But then he could've stated
11 that that he didn't know.

12 Q. He did state that, did he not?

13 A. I certainly didn't see it there that he stated
14 that. I didn't even see -- you know, you had to read
15 between the lines to know for sure what he was doing, is
16 all I'm saying.

17 Now, perhaps that is because I didn't see the
18 tables, but I go by the fact that he used the class prices,
19 when you know, as a cooperative, economists and represented
20 cooperatives he undoubtedly knew what they were paying, or
21 he should've known what they were paying.

22 Q. What who was paying?

23 A. What DFA was paying and the other coops that he
24 represented. I mean, he could've --

25 Q. Are you assuming --

1 A. -- found out what they were paying these
2 producer/handlers.

3 Q. Are you assuming that the producer/handlers
4 dispose all of their surplus milk to the DFA?

5 A. No, I'm not presuming that, but he said that he
6 represents something broader than DFA, as I recall.

7 Q. Really?

8 A. And that he was working with other cooperatives
9 in the area.

10 Q. Okay. Now, you haven't heard any of the
11 testimony of your clients here thus far in this proceeding,
12 correct?

13 A. No, I have not.

14 Q. Did you obtain from them information with respect
15 to their quoting your words here in critiquing Mr. Holland
16 on what they received for either Class One milk that is
17 purchased or surplus milk that is sold?

18 A. Right, I received information on surplus milk
19 that was sold.

20 Q. Okay. Does that include surplus milk that was
21 sold for Class One purposes to Mananuscapemade (phon.) in
22 Anchorage, Alaska?

23 A. No, I did not ask that.

24 Q. Okay. Were you aware of that?

25 A. Oh, yes.

1 Q. And you didn't -- that wasn't of interest to you
2 whether those sales -- what returns those sales brought?

3 A. Well, it might've been of interest, but the
4 particular interest was, you know, what they were selling
5 to the cooperatives.

6 Q. Do you know what portion of their sales -- of
7 their surplus they sold to the cooperatives versus what
8 they sold to Mananuscapemade?

9 A. I think Van Dam had some data in his tables on
10 that and I can't recall. It was less than 50 percent, but
11 I can't tell you the exact percentage.

12 Q. Well, do you recall the information presented by
13 the market administrator, or you didn't look at the MAs?

14 A. No, I did not.

15 Q. Okay. Well, let me represent to you that the
16 market administrator's data in the Pacific Northwest Order
17 shows that producer/handlers dispose of roughly, don't hold
18 me to the percentage, roughly 70 percent or so of the milk
19 that they do not bottle themselves.

20 A. Uh-huh.

21 Q. Okay. Roughly 70 percent of it goes to either
22 Class One or Class Two. Were you aware of that?

23 A. Yes, that's in the Van Dam statement, I believe.

24 Q. Now, did you inquire, make any study or any
25 determination of what was received for 70 percent of those

1 surplus sales?

2 A. No, I did not.

3 Q. On page 13 of your testimony when you say you're
4 -- this is at the top. Your research used the actual
5 prices paid by handlers from the cooperative for Class One
6 milk rather than the FMO minimum price.

7 A. Which page are you on?

8 Q. 13.

9 A. Okay.

10 Q. At the top.

11 A. Yep.

12 Q. What information were you relying on --

13 (Tape change.)

14 A. -- reports for prices paid on (indiscernible)
15 premiums.

16 Q. Dairy Market news premium --

17 A. Yeah.

18 Q. -- reports?

19 A. Yeah.

20 Q. Are you aware or I assume you would be aware as a
21 dairy economist and with your knowledge of federal order
22 markets and marketing conditions, that those are gross
23 prices, announced prices and do not necessarily reflect
24 that prices actually paid net for milk?

25 A. Yes, I'm aware of that.

1 Q. Okay. Well, then why did you use them?

2 A. That's data we've got available.

3 Q. You didn't seek out any superior data to make the
4 assertions you made there?

5 A. No, because I felt that -- you know, I feel that
6 those data are reliable enough to draw the generalizations
7 that I drew here.

8 Q. You also make the assertion about Mr. Holland at
9 the top of page 14, point three. He assumed that it is the
10 role of the FFMOs, which I take is federal milk marketing
11 orders to enforce over order premiums. From what did you -
12 -

13 A. Well, as you derive --

14 Q. Let me finish my question.

15 A. Sure.

16 Q. That rather astonishing assertion.

17 A. Well, it seemed to me as I read his testimony,
18 and even bringing up the subject of federal milk marketing
19 orders, that there was an assumption there that federal
20 orders somehow had a responsibility with respect to over
21 order premiums.

22 So, you know, that was just an inference that I
23 drew from his testimony.

24 Q. Can you give us the benefit of where, if I give
25 you his testimony, of what assertion was made that would

1 have led you to conclude and make that assertion?

2 A. If you'll give me the testimony and show me the
3 part that refers to over-order premiums, I'll tell you how
4 I drew that conclusion.

5 Q. Exhibit 32, page ten, approximately in the middle
6 of the page there's a sentence that we think is the only
7 reference to premiums in Mr. Holland's testimony.

8 A. Well, the implication is that somehow
9 producer/handler exemption destroys the ability to garner
10 over-order premiums and further depresses producer returns.
11 And all I'm saying is that, I don't think that that
12 implication -- that there is somehow federal orders had a
13 responsibility, a duty to protect over-order premiums, and
14 I, you know, I don't think that that's the case.

15 Q. But that statement is what led you to make the
16 assertion you made on page 14 --

17 A. Yes.

18 Q. -- of your testimony?

19 A. Yes.

20 Q. All right. Now, let me ask you a question or two
21 about comments you've made about Mr. Herbine's testimony.

22 First of all, Dr. Knutson, you are not a
23 certified public accountant, am I correct?

24 A. Oh, yes, that's right.

25 Q. And therefore, you do not participate in the

1 regular peer review that is undergone by certified public
2 accountants in their licensure procedures.

3 A. True.

4 Q. And you've never participated in any such peer
5 reviews; isn't that correct?

6 A. No. True.

7 Q. Okay. Nevertheless, you felt that --
8 nevertheless, you have criticized Mr. Herbine's accounting
9 testimony because it wouldn't pass, what, an economists'
10 peer review that you participate in?

11 A. I would argue anybody's peer review, because the
12 sample was not representative. You know, it may represent
13 the firms that are in his composite of 20 firms, but it's
14 not in any sense a representative sample. I'm not
15 questioning his accounting, you know. I'm questioning the
16 conclusions that he draws from 20 firms that are not
17 representative of producer/handlers certainly.

18 Q. I'm questioning what you mean by criticizing an
19 accounting work as not being subject to peer review, when
20 you're not a peer reviewer of accountants.

21 A. I'm not questioning, as I said. I'm not
22 questioning that he went through the right procedures in
23 developing his unit costs. What I'm saying is, the
24 conclusions that he drew from that, first of all, he didn't
25 take a random sample. Secondly, he had only produced two

1 producer/handlers as I understand it. Third, they -- you
2 know, they weren't from this area necessarily. And so he
3 used the consumer price index as opposed to a producer
4 price index, you know, to make some cost differences.

5 Well, these aren't consumer prices. They were
6 wholesale. They were wholesale costs. So there were a
7 number of very important strategic errors that were made by
8 him in drawing conclusions. Now, I'm not questioning that
9 he used the right accounting practices. What I'm
10 questioning is, his conclusions relative to the
11 representativeness and the usefulness in this hearing.

12 Q. Well, is it your testimony that because there are
13 only what, three fully regulated plants in Order 131 and
14 four substantial competitors in Order 141, that the only
15 useful plant cost information relating to that, would be to
16 take a random sample of those plants?

17 A. In order to draw statistical conclusions, you've
18 got to have about 30 plants. I mean, you just -- any
19 statistician will tell you that. You've got to have 30
20 observations.

21 Q. Did you understand his study to be a statistical
22 study?

23 A. Well, he used -- he and Kyron combined used
24 statistical techniques related to it to draw conclusions.

25 Q. Now, I'm talking about Mr. Herbine.

1 A. Okay. Okay.

2 Q. Did you understand his study to be some sort of
3 statistical study?

4 A. He represents it to be.

5 Q. Statistical?

6 A. He represents it to be representative of
7 producer/handler costs of production.

8 Q. At what level of production?

9 A. At that -- the processing, in the processing
10 function.

11 Q. Yeah, at what size level?

12 A. Oh, at the various size levels. The various
13 average size levels that he has in there.

14 Q. For the producer/handlers that he studied, what
15 size were they?

16 A. Oh, to tell you the truth, I don't know that.
17 But there are only two of them.

18 Q. Did you read his testimony?

19 A. Yeah, I did. There were only two of them.

20 Q. Right.

21 A. I mean, he doesn't make that very clear in the
22 testimony.

23 Q. Well, you didn't read his testimony in the
24 hearing. You only read his exhibits, as I --

25 A. That's true.

1 Q. His prepared testimony.

2 A. You didn't ask questions of Mr. Yale regarding
3 the number of producer/handler observations.

4 Q. Okay. But you're aware, are you not, that Mr.
5 Herbine was subject to extensive cross-examination in
6 Phoenix by Mr. Yale and Mr. Ricciardi and that that
7 transcript was available prior to this hearing.

8 A. Sure.

9 Q. Yeah. And you didn't think that before you made
10 the assertions about Mr. Herbine's work that you've made
11 that you might have availed yourself of the opportunity to
12 review his answers to Mr. Yale and Mr. Ricciardi's
13 questions?

14 A. I concluded that it was unnecessary, because it
15 would not qualify -- it would not pass statistical muster.
16 On its very own face, it wouldn't pass statistical muster.

17 Q. You didn't need to know how he would answer their
18 questions, in order to know that your comments are
19 sufficient with respect to his testimony? That's your
20 testimony?

21 A. Yes.

22 Q. Your curriculum vitae with respect to your dairy
23 economics work lists congressional testimony but not
24 hearing testimony, correct? The one you've submitted?

25 A. That's true. That's true.

1 Q. And you've testified a number of times over the
2 years for various interests in various proceedings of this
3 or similar nature?

4 A. Yeah. Probably three times. Not an extensive
5 number of times.

6 Q. Three times in federal order proceedings.

7 A. Yeah.

8 Q. Is that right?

9 A. Yeah.

10 Q. Do you consider yourself an advocate in these
11 roles?

12 A. No. I never become involved in a hearing, unless
13 I believe after studying the situation that the position is
14 defensible as an economist looking objectively at the
15 situation.

16 Q. And among other things over the years, that led
17 you to testify in New Jersey in support of abolishing their
18 regulatory minimum resale prices, correct?

19 A. Oh, I did, yes, I did.

20 Q. And in Maine, it led you to testify in support of
21 raising minimum resale prices; isn't that correct, Dr.
22 Knutson?

23 A. Well, I don't remember that in Maine. So I'll
24 have to defer. I do not recall.

25 Q. You don't recall that --

1 A. I do not recall it.

2 Q. -- in Okrestarian, Maine (phon.)?

3 A. Okrestarian. But I don't recall specifically
4 what I testified to.

5 Q. Okay. If you confirmed in your prior USDA
6 federal milk order testimony when you were working for
7 Hershey, that in fact, you had testified in Maine for
8 Oakhurst (phon.) in support of raising minimum retail
9 prices, you wouldn't contradict that today?

10 A. Well, I can't say. I'd have to go back and
11 review the situation.

12 Q. Okay. Thank you.

13 THE COURT: Mr. Marshall.

14 EXAMINATION

15 BY MR. MARSHALL:

16 Q. Good afternoon or evening, Dr. Knutson.

17 Welcome to Seattle. I'm Doug Marshall with the
18 Northwest Dairy Association here in town. We've met
19 before. Good to see you again.

20 Let's start with some topics covered in recent
21 cross-examination and then talk a little bit about your
22 prepared testimony.

23 I was interested in a quote that I wrote down, I
24 wanted to make sure I got it right. I believe it was in
25 response to a question from Mr. Berde, that there was no

1 evidence of disorderly marketing conditions in the Arizona
2 market, and in fact, that the producer/handler regulations
3 or the growth of Sarah Farms had promoted badly needed
4 competition in that market. Do I have that about right?

5 A. Yes.

6 Q. If during that same time frame that you described
7 that you and he were discussing the growth of Sarah Farms,
8 during that same time frame, a regulated plant had been
9 driven out of business, would that be evidence of
10 disorderly marketing conditions in that market?

11 A. If there were -- well, no, I guess I'd say no,
12 because firms go out of business all the time in the milk
13 business. So you know, having -- it's like switching
14 accounts. Is the switching of accounts a -- evidence of a
15 disorderly market, I would say no. You've got to know a
16 lot more than a firm going out of business to draw a
17 conclusion about disorderly marketing.

18 Q. In the definition of orderliness quoted on page
19 five of your testimony, you refer to disruptive competition
20 among handlers. Would handlers going out of business be
21 disruptive competition -- indicate disruptive competition?

22 A. There are handlers going out of -- you know, if
23 you've got a lot of handlers going out of business and it's
24 due to price wars, I would agree with that. That would be
25 evidence.

1 Q. And if there had been a handler that testified at
2 this hearing that he'd been driven out of business in part
3 because of difficult competitive pricing, you would have to
4 accept that?

5 A. One handler? No. I'm not willing to accept
6 that. He may have gone out of business because he was a
7 poor businessman.

8 Q. How many handlers would have to be driven out of
9 business to demonstrate disorderly marketing conditions?

10 A. Well, I can assure you this, in Arizona there
11 aren't many handlers to go out of business, and I don't
12 think you're going to drive Safeway or Kroger or the big
13 guys out of business. So it's the little guys that have
14 gone out of business. It's guys who haven't been
15 innovative. It's the guys who haven't kept up with what's
16 going on in marketing that have gone out of business in the
17 areas.

18 Q. Let's talk about some of these examples of
19 innovation that you've described.

20 I'm referring to your testimony page three, a
21 vast of different market segments. It's towards the -- in
22 the second new paragraph. I guess it's the second
23 sentence. These vastly different market segments create
24 opportunities for firms such as producer/handlers to serve
25 niche markets such as home delivery.

1 Are you aware of any regulated handlers in the
2 Pacific Northwest market that have either a direct sale
3 through home delivery or through independent distributors?

4 A. Well, I can't point specifically to them, but I
5 suspect there probably are in competition with the
6 producer/handler.

7 Q. I'll represent to you that VitaMilk in Seattle
8 and my company, Dairy Gold brand each have independent
9 distributors that are selling products on home delivery.

10 A. Uh-huh.

11 Q. Is that a niche market that is not available to
12 the regulated handler, home delivery?

13 A. No, it's a niche market clearly. That's what I
14 purport it to be here.

15 Q. Next you go on to talk about direct to consumer
16 sales. I can represent to you that Anderson Dairy in
17 Battleground, Washington has its own retail store right
18 there on the main street in Battleground.

19 A. And they're --

20 Q. Is it true that the small firms that you say are
21 going out of business are those that don't do direct to
22 consumer sales?

23 A. No, that's not my testimony there. It's not
24 that.

25 Q. Are you saying --

1 A. I do know that there have been producer/handlers
2 in the Seattle market, who have direct to consumer sales
3 who have gone out of business.

4 Q. Okay. But that's --

5 A. McKenna Dairy (phon.).

6 Q. That's an example of -- like who?

7 A. McKenna Dairy, I believe it was.

8 Q. But is direct to consumer sales part of your list
9 of innovative techniques?

10 A. Oh, absolutely.

11 Q. You go on to talk about quality of products
12 having specific characteristics, and on the next page, you
13 talk about quality, freshness, taste, because they know
14 where it comes from.

15 Are you aware of programs that exist in this --
16 that have existed in this Puget Sound market to certify to
17 consumers the kind of farms milk comes from, as it might be
18 sold to and through a regulated handler?

19 A. No, I'm not.

20 Q. That would be innovative, would it not?

21 A. Yes.

22 Q. And, in fact, in that particular case, a
23 certification is it does not contain RBST, which is the
24 next thing you mentioned, that would be innovative as well,
25 right?

1 A. Yes.

2 Q. So if there was a company in a small-sized
3 category that was regulated, and was selling on that basis,
4 was using -- selling to somebody who was doing home
5 delivery, would you say that they were innovative?

6 A. Sure.

7 Q. And what if that same plant had been -- testified
8 at this hearing that they'd been driven out of business in
9 part because of competition from producer/handlers?

10 A. I suspect you're probably right. They may have
11 testified to that point, in part.

12 Q. So you're saying that that --

13 A. That producer/handlers therefore being more
14 aggressive, probably more efficient in their operation.
15 And you've got to look a lot of things when you say they've
16 been driven out of business.

17 Q. Let's talk about more efficient in their
18 operations. Size is a function -- efficiency is a function
19 of size, is it not?

20 A. In part.

21 Q. What if the sizes are the same, that wouldn't be
22 a factor, would it?

23 A. Well, no. No, that wouldn't be a factor.

24 Q. What if the dairyman that had been driven out of
25 business had high wage costs because of a union contract,

1 would the non-union competitor be more innovative, in your
2 opinion?

3 A. Oh, yes, absolutely.

4 Q. Ahhh, a note.

5 A. Producer distributors, you know, by virtue of
6 being non-union, you know, that's an innovation.

7 Q. Are you aware that at least one of your clients
8 is unionized?

9 A. They may be, yes. I didn't ask that question.

10 Q. It was relevant to the considerations, though, as
11 you studied this market, was it not, which plants have high
12 wage costs and which do not?

13 A. No, I don't think it's relevant to the issue of
14 how you price milk.

15 Q. Oh, okay. But you've testified that clients who
16 do have lower wage levels are more innovative, and I
17 believe that does apply to some of your clients. Is it
18 your testimony that the secret of innovation is low wages?

19 A. No, I'm not arguing that the secret of innovation
20 is low wages, no. But again, I'm not sure how that relates
21 to the issue of how you price milk.

22 Q. Can you give me an example of any innovative
23 practice by any of your clients in this Order 124 market
24 that hasn't also been utilized by regulated handlers that
25 are small in the same size category --

1 A. And my answer is --

2 Q. Let me finish the question.

3 A. Okay.

4 Q. That have not been utilized by regulated handlers
5 in the same size category as your clients.

6 A. And the answer is no, but at the same time, it
7 may be because of the clients the producer/handlers that
8 they found it necessary to compete with those innovative
9 techniques. Now, I don't know that for a fact, but that's
10 certainly a relevant consideration.

11 Q. You refer to the regulatory flexibility Act and
12 studies that you believe indicate that it is small
13 businesses that are more innovative; is that correct?

14 A. Right.

15 Q. Do you believe that small regulated handlers are
16 less innovative than small producer/handlers?

17 A. As a general principle, I would say yes.

18 Q. What's the basis for that opinion?

19 A. Because they've combined the producer function
20 with the processing function. That's an important
21 innovation in the dairy industry.

22 Q. Is it your testimony that in the dairy business,
23 other than the obvious fact of vertical integration smaller
24 handlers are more innovative than larger handlers, whether
25 they're regulated or not?

1 A. As a general rule, yes.

2 Q. And why wouldn't or perhaps you do agree with me,
3 that a small regulated handler has the same opportunity to
4 expand as a small producer/handler?

5 A. Well, yeah, I would say that there's the same
6 opportunity to expand, yes.

7 Q. If there were an exemption from regulation for a
8 small regulated handler, would there not be a lesser
9 barrier to entry in the regulatory -- regulated milk
10 market?

11 A. No. No. An exemption does provide a reduction
12 in barrier to entry which is very important to increase
13 competition in the milk processing business.

14 Q. I'm not sure we're tracking here, because I think
15 you answered the question earlier than I was asking it, so
16 let's start over here.

17 Would there be a reduced barrier to entry if
18 small regulated plants could be exempted and while they
19 didn't meet producer/handler criteria?

20 A. Well, I don't know exactly why you did that.
21 They buy milk. I don't understand why you do that. The
22 big feature of a producer/handler is that they both produce
23 and process --

24 Q. How does that help --

25 A. -- and distribute their milk.

1 Q. How does that help them enter the business in
2 ways that a regulated handler cannot?

3 A. Well, does it help them enter the business? It
4 helps them enter the processing business quite clearly, by
5 virtue of having an individual source of supply in their
6 operation, you know. And that provides an entree into the
7 processing business have a direct source of supply, not
8 having to go through a cooperative, for example.

9 Q. He has farmer capital investment, does he not?

10 A. He has farmer capital investment, yes.

11 Q. So it seems to me that a barrier to entry would
12 be reduced if we would give all small plants a break from
13 the tax that you described.

14 A. You're not imposing a tax on the small plant. He
15 buys milk. You're imposing a tax on the producer/handler
16 who doesn't buy milk.

17 Q. The distinction you're drawing is the purchase
18 and non-purchase?

19 A. Yes.

20 Q. I'll share with you that here in the State of
21 Washington we have sales and use taxes, sales are taxed, so
22 is use when the use is not the result of a purchase. Sales
23 and use tax.

24 A. Uh-huh.

25 Q. Is that a distinction you wish to draw?

1 A. You can draw that distinction. Does it apply to
2 milk?

3 Q. As a matter of fact it does. Are you familiar
4 with the concept of sales and use tax?

5 A. Yes.

6 Q. Is it tax that you're describing any different?

7 A. But is a tax. I mean, that's all I'm saying,
8 it's a tax.

9 Q. And why shouldn't there also have a use tax that
10 goes along with it so that those who have avoided the tax
11 will pay for the acquisition of that product through means
12 that are taxable?

13 A. Simply because they've taken on increased risks
14 associated with performance of both functions and are a
15 more competitive factor in that marketplace, and as I said,
16 federal milk marketing orders are designed to not provide
17 barriers to entry, to foster competition and entry into
18 milk markets.

19 Q. So it's your testimony that having a regulated
20 pricing program that applies to very small regulated
21 handlers does not create a barrier to entry; is that
22 correct?

23 A. No. No. No, it does not.

24 Q. It does not create a barrier to entry?

25 A. No.

1 Q. Interesting.

2 All right. Let's talk a bit about some of your
3 other testimony. I believe you referred to some giants of
4 the industry on page two of your testimony you identified
5 some of them, and I'm going to ask you a series of
6 questions related only to the Order 124 marketing, that is
7 to say, the Pacific Northwest market, and let's go through
8 this list.

9 Is Dean's Food active in this market, sir?

10 A. No.

11 Q. Is National Dairy (inaudible)?

12 A. No.

13 Q. Is Kroger or Safeway?

14 A. I believe they are, yes.

15 Q. Is DFA?

16 A. No.

17 Q. Is Land O' Lakes?

18 A. No.

19 Q. Is this paragraph generally speaking relevant to
20 Order 124 in your opinion, yes or no?

21 A. Oh, yes, I would argue it is.

22 Q. You go on to say something about the competitive
23 fringe of smaller independent processors.

24 First of all, what do you mean independent.
25 Independent of what?

1 A. Independent in not being owned by a national
2 company or a national chain.

3 Q. What percentage or what number of dairy
4 processing plants in the Pacific Northwest or owned by a
5 national organization?

6 A. I can't answer that question. I have not
7 received that information.

8 Q. If the vast majority were in that category, would
9 it change your testimony in any way?

10 A. No.

11 Q. You don't care about the fact that that doesn't
12 describe the Pacific Northwest market?

13 A. Well, certainly the dominance of integrated
14 retailers processing milk in a dominant cooperative still
15 is described correctly, as far as the market is concerned.

16 Q. As far as this market is concerned?

17 A. Yes.

18 Q. You're referring the Sam's Club, Costco, Wal-Mart
19 part of your testimony?

20 A. No, I'm saying the dominance of Kroger and
21 Safeway in the market, a dominant cooperative, that
22 certainly applies to this market.

23 Q. Are Kroger and Safeway in this market accounting
24 for as much as half of the sales at retail in the Pacific
25 Northwest market area?

1 A. I can't answer that.

2 Q. By the way, to all the grocery stores.

3 A. I'm not sure about the answer to that question.

4 Q. Have you ever heard of Albertson's?

5 A. Sure I have.

6 Q. I'll represent to you they're very active here.

7 A. But it's another dominant retailer.

8 Q. Yes, indeed it is.

9 You testified earlier that firms below some level
10 and I don't recall the level, were basically the ones going
11 out of business, they're history. Do you have any concern
12 about lack of competition if, in fact, that trend
13 continues?

14 A. Oh, absolutely I'm concerned about that.

15 Q. Could we address that trend by removing from
16 regulation those small plants?

17 A. Oh, we could, sure.

18 Q. In your testimony, you referred to the Cornell
19 study as having minimum size four times the three million
20 pound threshold that would be 12 million pounds; is that
21 right? Or was it 20 million under other examination?

22 A. It was 20 million.

23 Q. So your testimony --

24 A. The minimum size is 20 million.

25 Q. So your testimony about four times the three

1 million pound threshold is inaccurate?

2 A. Well, I won't classify it as being inaccurate.
3 It makes the point where --

4 Q. I'm trying to give you the opportunity to change
5 it right now if --

6 A. Well, the minimum size that they studied was 20
7 million pounds, and that's -- that presents an even more
8 extreme situation, if you will. Five times, six, seven
9 times.

10 Q. So is it your testimony that plants smaller than
11 that are the ones that are going out of business?

12 A. Yes. The Cornell study, yes. The Cornell study
13 was based upon the notion of studying the costs of
14 production for plants that were likely to be in the
15 business, as you looked down the road in the future of the
16 milk industry. And that was whole purpose of that Cornell
17 study. What are their characteristics.

18 Q. The Cornell study also identified a number of
19 other factors to be considered, and I think you enumerated
20 them.

21 A. It certainly did, yes.

22 Q. One of them was the number of miles traveled per
23 month in delivery. Another was population density.

24 A. Yep.

25 Q. What do you know about the Pacific Northwest

1 market in terms of population and density?

2 A. Oh, I've not studied that issue.

3 Q. Would that effect any of the opinions you've
4 given in your testimony, or is it not relevant to any
5 opinions you've given in your testimony?

6 A. I'm not sure that it has relevance to the issue
7 of how you price milk. It might have relevance to the
8 issue of competitiveness in the market.

9 Q. Would it have relevance to the size of plant that
10 might be ideal in serving a small isolated market?

11 A. Oh, yes, it might. Yes.

12 Q. So there are other factors than whether they just
13 meet the Cornell study; is that correct? Or whether they
14 meet the size of these plants studied by Cornell?

15 A. That's exactly the point I was making. That
16 there are other factors to be considered besides size,
17 which Mr. Herbine, Mr. Kryon and indirectly, Mr. Holland
18 relied heavily upon the size issue. And what you're doing
19 in this case is placing a size limit.

20 Q. What if the national size of a market would be
21 say, five million pounds, let's say, a small market like
22 Medford, Oregon, which is I'll represent to you about 275
23 miles south of Portland, up in the mountains. There's only
24 going to be room for one producer/handler or regulated
25 plant in that market, right?

1 A. That might be true.

2 Q. And is it your testimony that the
3 producer/handler should have the advantage of a different
4 regulatory structure in that situation, so that he can be
5 the one that succeeds in that market because of his
6 innovation and vertically integrating?

7 A. Well, he -- my answer is that first of all you've
8 not -- you don't by the regulation that's proposed assure
9 or consider all of the factors that effect the competitive
10 position of a producer/handler. Moreover, you presented a
11 hypothetical here that is probably pretty much of a
12 stretch, because you've probably got an Albertson or a
13 Safeway or a Kroger in that market against which that
14 producer/handler will be competing.

15 Q. All I know, sir, is we do have a five million
16 pound plant there, and we could be a lot more innovative if
17 we had lower pricing.

18 A. Well, yeah, I suppose you could. But you
19 certainly have big grocery chains that are in that market
20 as well.

21 Q. Oh, sure.

22 One of the other factors that you mentioned in
23 the list of other factors to be considered, number five,
24 the percent utilization of capacity and number thirteen,
25 the percent of plant capacity utilized.

1 By the way, what's the difference?

2 A. There probably isn't any difference. You notice
3 that when I -- I probably double-counted that there.

4 Q. Was that your error or was that list of thirteen
5 --

6 A. That's my error.

7 Q. So Cornell didn't just list somewhere 17 factors
8 to be considered.

9 A. Well, they didn't list the factors one through
10 17. They listed all of those factors, but they didn't list
11 them 1 through 17.

12 Q. Okay.

13 A. I had to go through and compile it from the
14 Cornell study.

15 Q. Is it your -- would you agree with me that the
16 percent of utilization of capacity is a determined one of
17 many, but a determinate of the cost of operating a plant?

18 A. Absolutely.

19 Q. Would that apply to a manufacturing plant as well
20 as to a bottling plant?

21 A. It does.

22 Q. Have you studied the balancing costs of plants in
23 the Pacific Northwest market, sir?

24 A. No, I have not.

25 Q. So you don't know what those balancing costs are,

1 do you?

2 A. No, I do not.

3 Q. What's the basis for your statement that the
4 \$1.50 hundred class three charge that we assess is
5 exorbitant?

6 A. Well, just on the basis of experience as an
7 economist.

8 Q. And what does that experience tell you should be
9 the correct cost to assess to people who use a balancing
10 plant in the Pacific Northwest market here in the first
11 years of the century?

12 A. All I'm saying is that that is far beyond the
13 bounds --

14 Q. What --

15 A. I'm not -- I don't have a specific --

16 Q. Would it depend on plant utilization of capacity,
17 sir?

18 A. Well, to the extent -- well, no, I would argue no
19 because to the extent that sales by the producer/handler to
20 the coop increases their percent utilization of capacity,
21 the coop benefits from it.

22 Q. We should do it for free then, right?

23 A. No, I didn't argue you should do it for free.

24 Q. What did you argue we should do it for?

25 A. I've got no specific number. I've said that

1 already.

2 Q. As an economist, then how do you know \$1.50 is
3 too great?

4 A. Well, because as I said, it increases the amount
5 of volume processed by the coop, which we've already
6 determined through the questioning, reduces cost, because
7 it increases the utilization of capacity. I'm not saying
8 there shouldn't be any charge, but \$1.50 to \$2 just seems
9 to me to be an unreasonable charge, in light of the fact
10 that, you know, the coop benefits from those sales.

11 MR. MARSHALL: Yeah, I'll defer to any other
12 counsel who wants to ask questions. Thank you very much,
13 sir.

14 THE COURT: Mr. English.

15 EXAMINATION

16 BY MR. ENGLISH:

17 Q. Dr. Knutson, Charles English for Team Foods and
18 Chandler Foods.

19 I'm generally intrigued by your comments about
20 the Arizona market, given the fact that your own testimony
21 is you never spoke with Shamrock.

22 You certainly have testified, have you not, that
23 you think that the Arizona market was not particularly
24 cooperative and Sarah Farms has provided new and important
25 competition in that market.

1 A. Absolutely, yes.

2 Q. But you've never read the testimony and you never
3 reviewed the cross-examination of Mr. Kruger, who testified
4 almost eight weeks ago in Arizona, have you?

5 A. No.

6 Q. So you don't know that he discussed the movement
7 of many customers in the Arizona market for pricing
8 considerations, did you?

9 A. No.

10 Q. And you did not know that he testified that a
11 large national customer has benchmarked Shamrock Foods, by
12 the way you couldn't remember the name earlier, so I just
13 want you to realize it's Shamrock Food Company, sir. You
14 don't know that Mr. Kruger testified that a large national
15 customer has benchmarked the Shamrock Foods Company and
16 they have the lowest cost of any processor that serves that
17 large national customer, do you? You don't know that?

18 A. No, I don't know that.

19 Q. And you don't know that Shamrock Foods prices its
20 milk to that customer and other customers like that, and
21 would certainly like to do it for Costco if it could, but
22 it can't, that you don't know that he testified that it
23 sells all of its milk to those customers at its direct
24 cost, do you?

25 A. No.

1 Q. And the other two plants in that market are
2 Safeway and Kroger plants, correct?

3 A. Yes.

4 Q. So their internal margins or whatever the company
5 decides they are is transfer pricing, correct?

6 A. Right.

7 Q. So your conclusion to that market is competitive
8 is based on no information regarding Safeway, Kroger or
9 Shamrock Foods Company, is it, sir?

10 A. My conclusion is based upon the notion that the
11 competitiveness has been added to by Sarah Farms, and it's
12 badly needed.

13 Q. But how do you know it's badly needed without
14 knowing what the condition of the market was before they
15 entered, sir?

16 A. Mr. English I know it because of the
17 concentration within the market. When you've got a flow of
18 concentration that exists in that market, you have clear
19 potential for oligopoly pricing of milk in that market, and
20 increased competition reduces that potential, which is
21 very, very positive in which federal milk marketing orders
22 should be concerned about.

23 Q. But you, sir, having done no investigation
24 actually don't know whether that's the condition of that
25 market, do you, sir?

1 A. I know of the concentration of the market.

2 Q. But you don't know with that concentration, that
3 there has actually been any higher prices, because you've
4 not studied it, have you, sir?

5 A. No, I have not studied global prices.

6 Q. Thank you, sir.

7 Now, you've discussed the innovation of Sarah
8 Farms in serving the Hispanic market, correct?

9 A. I've studied the innovation of --

10 Q. You said that the producer/handler Sarah Farms
11 was innovative in answer to a question by --

12 A. Yes, yes.

13 Q. -- Mr. Beshore --

14 A. Yes, yes.

15 Q. -- and --

16 A. Now I understand the question, yes.

17 Q. Okay. But your client does not have a bilingual
18 label for the Hispanic market, does it?

19 A. I don't think that the Hispanic label is a
20 crucial issue. It's the price that they look at.

21 Q. Like the price that they can charge because
22 they're not regulated, right, sir?

23 A. No. No, I didn't say it was the price that they
24 could charge because they're not regulated. The price that
25 they could charge because they developed a system, a niche

1 market and to serve.

2 Q. And isn't it true, sir, that Shamrock has a
3 bilingual label and Hispanic advertising so they have tried
4 to develop that niche market.

5 A. Well, they may have. I don't deny that. They
6 may have done it in competition.

7 Q. And the Sunland brand, which is their value
8 brand, that is, the one they sell at direct cost is the
9 label with Hispanic brand, did you know that, sir?

10 A. No, but they sell it in competition.

11 Q. They sell it in competition.

12 A. Yes.

13 Q. And guess what, sir, you didn't read the
14 testimony of Mr. Kruger that said, he can't get that in
15 because of price, but he sells it at direct cost, which the
16 national company benchmarked him as the lowest cost, sir.

17 A. Okay.

18 Q. And so, sir, doesn't that mean, as you said
19 yourself, that market goes for price.

20 A. That market goes for price, goes for efficiency,
21 I don't have any problems with that and Sarah Farms is a
22 great contributor to that.

23 MR. ENGLISH: Thank you, sir.

24 EXAMINATION

25 MR. MARSHALL:

1 Q. Doug Marshall again, Mr. Knutson.

2 You mentioned a moment ago in that cross-
3 examination about knowing the level of concentration in the
4 Arizona market. Do you know the level of concentration in
5 the Order 124 market?

6 A. No, I already said that I did not.

7 Q. I can represent to you that Exhibit 5, in fact,
8 maybe you have a copy up there, has identified 14 --
9 Exhibit 5 is the market administrator's exhibit.

10 A. Okay.

11 Q. Has identified 14 plants in the Pacific Northwest
12 market that are not part of Kroger or Safeway or any other
13 retail chain. In other words, not captive plants, 14 of
14 them. Would you expect there would be a low level of
15 concentration by the normal calculations of concentration -
16 -

17 A. Oh, I don't know that for a fact. I'd have to
18 four firm concentration ratio to pull up the retailer level
19 and processor level to know that.

20 Q. Are you aware that earlier one of your clients
21 testified the Pudget Sound market is very competitive.

22 A. Yes, and I would guess it is very, very
23 competitive, fairly competitive because of the fact that
24 you've got producer/handlers in the market.

25 Q. I refer you to your testimony. I believe it's

1 page six. My analysis indicates that Seattle processors
2 have enjoyed some of the highest gross margins in the
3 United States. Is that statement consistent with what
4 you've just described?

5 A. Well, let me clarify what I was trying to get and
6 it might not be --

7 Q. Please.

8 A. It may not be real well stated. The processor
9 retailer margin in this market is clearly the highest in
10 the country.

11 Q. Explain what you mean by that, sir.

12 A. The margin between the price of raw milk and the
13 retail price in the market is the highest in the country.
14 I think the data introduced by the market administrator, as
15 I understand it, indicates that. The table.

16 Q. He indicates retail pricing?

17 A. It indicates the gross margin is among the
18 highest in the country, if not the highest.

19 Q. Let me give you a copy of Exhibit 5.

20 MR. UNIDENTIFIED: Your Honor, just for the
21 record, if he could identify what he gave the witness.

22 Q. (By Mr. English) Mr. Knutson, I've just give you
23 a copy of Exhibit 5 done by the market administrator. Is
24 that what you're referring to?

25 A. No.

1 Q. Can you tell us what you're referring to?

2 A. I'm referring to a table which gives for each
3 market in the country a processor retailer margin a retail
4 price, a Class One price for federal orders. I'm not sure
5 what exhibit number it is, but it's got them basically for
6 all of the markets in the country including the --

7 MR. ENGLISH: Does anyone know whether that's
8 been entered into evidence? I'm not aware that that's been
9 entered as an exhibit.

10 THE WITNESS: I was under the impression that it
11 was.

12 Q. (By Mr. English) I don't think it's important
13 whether it's an exhibit or not. I now know what you mean,
14 and you've corrected the inaccurate statement that you had
15 made that the Seattle processors have enjoyed some of the
16 highest gross margins in the United States. That was an
17 intent to correct that statement.

18 A. It was not intended, I just say processors. It
19 was intended I say processor retailers.

20 Q. Based on your conversations with both your
21 clients and others, do you have any basis for concluding
22 how that retail to -- farm to retail spread is divided
23 between processors, wholesalers and retailers?

24 A. I really don't, no. That's a very difficult
25 issue to get at because we don't know wholesale prices.

1 MR. YALE: Your Honor, during that break -- this
2 is Ben Yale, in regards to this issue of this exhibit, I
3 believe it was a part of some websites we asked him to take
4 notice of of USDA AMF's dairy programs' website, and that
5 had the retail prices by markets throughout the United
6 States by month to percent (inaudible), as well as the
7 federal minimum price.

8 THE COURT: Okay. And that's how it was noticed
9 you said?

10 MR. YALE: I believe that's how it was noticed,
11 Your Honor, and it is available and is part of the USDA
12 report and is part of I think the marketing order statistic
13 or something under their website on dairy programs.

14 THE COURT: Thanks for clarifying that.

15 Q. (By Mr. English) Last area of questioning, I
16 think, Mr. Knutson. On page seven, you were describing the
17 Pudget Sound and successor Pacific Northwest Federal Order
18 talking about the first new paragraph on page seven.

19 The Class One differential was increased in
20 December of 1989 from \$1.85 per hundred weight to \$1.90 per
21 hundred weight. Is it also true that the predecessor
22 Washington Federal Order, the federal order price was
23 reduced from \$1.95 per hundred weight to \$1.90 per hundred
24 weight?

25 A. Could well be, yes.

1 Q. The cooperative premium tacked on an additional
2 simple average of 67 cents per hundred weight to that
3 \$1.90. That's your testimony?

4 A. Yes.

5 Q. What time frame do you refer to there, 1989?

6 A. Yes.

7 Q. And what evidence do you have for that assertion?

8 A. I used federal order data.

9 Q. From 1989?

10 A. I'm not sure of the data. I'd have to go back
11 and check the period in which the data on the size of award
12 or premiums it covers. I don't think it was in December
13 1989 alone. I think it was in a larger time period that
14 was comparable to what was represented for the Arizona
15 market, but I -- frankly I would have to go back and check
16 to look at the time period, but this is federal order data.

17 Q. The sentence then goes on to read with a range
18 from 30 cents to \$2.13. That's quite a range, isn't it?

19 A. It is. It certainly is, yes.

20 Q. What would you contribute such a range?

21 A. You know, frankly I don't know.

22 Q. Might it be disorderly marketing conditions?

23 A. I doubt it, no. I don't think so.

24 Q. Well, you described earlier chaotic markets is
25 those including substantial changes in price, right?

1 A. If --

2 Q. Did you not?

3 A. Yes. Yes. Yes. But this is a range in a price
4 established by the cooperatives or the cooperative in the
5 market, not by federal orders. I don't consider these
6 over-order premiums to be a reflection of disorderly
7 marketing. As I said, you know, federal orders were never
8 designed to deal with issues of over order premiums. In
9 fact, if anything, as I say in the testimony, they disrupt
10 -- they are disruptive of --

11 Q. You think they're a bad thing?

12 A. Huh?

13 Q. You think they're a bad thing?

14 A. I'm not saying they're a bad thing, necessarily,
15 but I'm saying is they make the job of the market
16 administrator more difficult. They make the job of USDA
17 more difficult.

18 Q. In what respect, sir?

19 A. Because they stimulate milk production. They
20 mean that the prices that are set by USDA are not the
21 prices that exist in the marketplace.

22 Q. If the prices that are charged that you refer to
23 as premiums bear the cost at least in part of balancing and
24 other factors, would you still hold the view that they
25 would cause producers to respond by increasing production?

1 A. It's those other factors that I'm concerned
2 about.

3 Q. I'm sorry, could you explain that?

4 A. Well, you'll have some difficulty convincing me
5 that the range of 30 cents per hundred weight to \$2.13 per
6 hundred weight is a reflection just of cost.

7 Q. I would not say that.

8 A. Okay.

9 Q. I would say 30 cents is -- I know the history,
10 and I know that for much of that period, the service charge
11 has been only about 30 cents, and that is truly a service
12 charge for balance and producer payroll administration of
13 testifying, I guess. I don't mean to do that. I represent
14 to you that that's the case.

15 MR. UNIDENTIFIED: (Inaudible.)

16 MR. ENGLISH: No, perhaps later.

17 Q. (By Mr. English) Other times, there have been
18 premiums but only at times. Are you familiar with anything
19 called Northwest Milk Marketing Federation in the Pacific
20 Northwest market?

21 A. I'm familiar that it exists.

22 Q. It does?

23 A. That there is such an organization, yes.

24 Q. There is?

25 MR. UNIDENTIFIED: (Inaudible.)

1 Q. (By Mr. English) When did you most recently hear
2 about it?

3 A. That it has existed is all I'm saying.

4 Q. Has existed.

5 A. Yeah.

6 Q. I agree with that.

7 A. Yeah.

8 Q. Would it surprise you that it hasn't existed for
9 nearly two years?

10 A. It wouldn't surprise me to know that.

11 Q. Would it surprise you that recently -- would it
12 surprise you that one of the reasons it no longer exists is
13 because of failure of producer/handlers including your
14 clients to cooperate with them?

15 A. No, that wouldn't surprise me either.

16 Q. That would you say, is a good thing?

17 A. I wouldn't say it's a bad thing.

18 Q. So there is an example, is it not, of a change in
19 market conditions?

20 A. But it's not necessarily disorderly marketing.

21 MR. ENGLISH: Okay. No further questions.

22 MR. CHRIST: Your Honor, I'm Paul Christ on
23 behalf of Dean Foods.

24 EXAMINATION

25 BY MR. CHRIST:

1 Q. Ron, I want to ask you a couple of questions
2 about economic efficiency, a little more arcane (phon.).

3 This concerns an example of an inefficient
4 producer in the market, whose costs may be 50 cents a
5 hundred weight higher than the blend price. Would it be
6 wise for the pool to pay him more than other producers,
7 simply to keep him in business and competitive?

8 A. No.

9 Q. It would be a mistake for two reasons. One would
10 be it would not be uniform prices to producers, correct?

11 A. Well, now you're talking about a producer/handler
12 or are you just talking about a --

13 Q. No, I'm just talking about a producer.

14 A. Okay, so it's --

15 Q. Yeah, the second defect would be that that would
16 be an inefficient allocation of resources.

17 A. Yeah, I agree with that.

18 Q. Okay. Let's consider the other end of the
19 market. In the given market environment, one processor has
20 a cost of maybe five cents a gallon more than the
21 difference between the Class One price and the market value
22 of products.

23 Would it be wise for the federal order to give
24 him a break on the price so he could compete?

25 A. No.

1 Q. No. And again, that would not be uniform prices
2 to producers or bottlers.

3 A. Right.

4 Q. And it would be an inefficient allocation of
5 resources.

6 A. Right, right.

7 Q. Okay. Now, consider if the farmer of the
8 inefficient farm and the processor of the inefficient
9 processor would form a partnership in a producer/handler
10 operation. In this event, would the terms of trade improve
11 for that organization than when they were operating
12 independently?

13 A. Would the terms of trade improve?

14 Q. Yes. The same market value as a finished
15 product, the same cost of production?

16 A. No.

17 Q. They would not improve?

18 A. They would not improve.

19 Q. Would they -- the production activity have the
20 opportunity to receive more than the blend price for its
21 output?

22 A. If it were a producer/handler now you're saying?

23 Q. Yes.

24 A. Well, Paul, you don't know, you know, whether it
25 does or doesn't. I mean, under the hypothetical, I agree.

1 Q. Okay. And the same thing for the bottler, the
2 bottling operation of the producer/handler, is it possible
3 that they would pay less than the Class One price?

4 A. Sure it is, but I don't see that in any of the
5 producer/handlers that I represent in this case.

6 Q. Okay.

7 A. Now, you're presenting a hypothetical that is not
8 relevant.

9 Q. Well, yes, I'm presenting a hypothetical of two
10 independent firms fully subject to the pooling and pricing
11 regulation and one combined firm is not.

12 A. Uh-huh.

13 Q. There's a gap between what the producer receives
14 and what the processor pays when they're independent
15 entities, and the gap does not exist in the case of one
16 entity; is that correct?

17 A. Well, there's a gap there, yeah. But, you know,
18 to know the extent to which that gap exists, you've got to
19 evaluate the situation from both standpoints and the cost
20 relationships would be -- could be substantially different
21 once they combined into a single operation, than they were
22 in your individual operation situation. That's why, you
23 know, an unreasonable hypothetical.

24 These guys here that I represent in this case,
25 built their business on the notion of an efficient producer

1 segment, and efficient processing segment.

2 Q. And that implies that they would be competitive,
3 even though the two activities were independent. If they
4 are efficient --

5 A. Not necessarily, Paul, absolutely not. As an
6 economist, you know better than that.

7 Q. I'm not sure that --

8 A. An integrated operation is quite different than
9 two separate operations.

10 Q. Okay. Well, let's do them one at a time.

11 A. You know, they're quite different. The
12 challenges are quite different in an integrated operation.

13 Q. Would you expect an integrated operation to be
14 more or less efficient than two independent operations?

15 A. I would expect it to be more efficient. They are
16 --

17 (Tape change.)

18 Q. Okay. You stated earlier that if your clients
19 were subjected to the so-called tax, that they would have
20 difficulty surviving.

21 A. Yes.

22 Q. Okay.

23 A. Absolutely.

24 Q. And does that imply that they are not efficient
25 enough to produce milk at the blend price and process milk

1 at the Class One price?

2 A. I'm not sure it implies that at all. I think it
3 implies that these firms have built their business on an
4 integrated operation under a certain set of rules with
5 certain risk factors associated with them. And you changed
6 the rules of the game, you know, and you've placed them in
7 a very difficult position, and you know, you've essentially
8 said, if you put this limit into effect, you've essentially
9 said, producer/handlers are not going to be competitive
10 factors anymore in the milk business in the U.S.

11 And in my view, that's inconsistent with the
12 history of producer/handler regulation. It's inconsistent
13 with maintaining competitive markets for milk. It's
14 inconsistent with maintaining efficiency in the dairy
15 industry.

16 Q. But you did assert that they would not be
17 competitive, if they were subjected to the same prices for
18 milk produced and the same costs of milk for Class One use.

19 A. When you look at the risk factors associated with
20 both operations combined together, I agree with that
21 statement.

22 MR. CHRIST: Okay. We'll leave it at that.
23 Thank you very much.

24 THE COURT: Anyone else on this side? Yes, Mr.
25 Berde.

1 MR. BERDE: Sidney Berde.

2 EXAMINATION

3 BY MR. BERDE:

4 Q. I take it, Dr. Knutson, that your position is
5 that you're in favor of encouraging the growth of
6 producer/handlers because they -- as they grow become a
7 competitive factor in the market, and stimulate competitive
8 activity in the market that might not otherwise exist.

9 A. Yes.

10 Q. Are you aware that in the Secretary's view that
11 precise circumstance would be justification to and I'll
12 quote from the Secretary's decision, to call a public
13 hearing and which should be held to give immediate
14 consideration to the regulation of producer/handlers under
15 the order.

16 A. Could well be.

17 Q. It could well be?

18 A. Yes.

19 Q. And who should we listen to you or the Secretary?

20 A. You ought to listen to, you know, the totality of
21 the record and the role of federal orders and then make a
22 decision.

23 Q. Well, if the role of federal orders is to provide
24 uniform prices among handlers and uniform price to
25 producers --

1 A. Uniform prices for milk purchased.

2 Q. We've already decided to the -- at least to the
3 satisfaction to every court that has considered the
4 question, that the term purchase means acquired for
5 marketing.

6 Now, do you persist in rejecting the law in favor
7 of your opinion?

8 A. I persist in the need to re-evaluate that
9 decision, yes.

10 Q. Well, but it hasn't been re-evaluated and what
11 you're persisting in doing, I suggest, is to simply reject
12 the state of the law.

13 A. The state of the law is clear enough. It's
14 provided exemption for producer/handlers.

15 Q. The law has provided that?

16 A. They state the policy as to provide exemption for
17 producer/handlers. That has been the historic state of the
18 policy.

19 Q. To what extent has the policy been to exempt
20 producer/handlers? To what extent?

21 A. To what extent?

22 Q. Yes.

23 A. I'm not sure what you're asking.

24 Q. Well, I'll suggest the -- what I'm asking is,
25 isn't it to the extent that they are not competitive

1 factors in the market?

2 A. No, I don't think so. I would hope not.

3 Q. Well, isn't that what the law --

4 A. I would hope not.

5 Q. Isn't that what the --

6 A. Okay. What you're saying, Mr. Berde, is that
7 when they become competitive factors, then the USDA ought
8 to stop competition. That makes me no sense to me
9 whatsoever, and I can't imagine the Secretary making that
10 decision.

11 Q. The Secretary could decide that they -- that it's
12 time to stop the exemption of producer/handlers at the
13 point where they are a competitive factor in the market.

14 A. And I would say that that would be a very, very
15 poor policy for USDA to pursue.

16 Q. I see. But if that is the policy of the
17 Secretary, are you suggesting that your opinion should take
18 precedence over the Secretary's policy?

19 A. And I'm not sure that's the policy of the
20 Secretary.

21 THE COURT: Isn't that why we're having this
22 hearing?

23 MR. YALE: I would hope, yeah.

24 THE COURT: I mean, the Secretary's going to make
25 a decision based on what she hears.

1 I'm going to ask the folks in the front row, Ms.
2 Deskins, or colleagues, do you have questions? No
3 questions? Okay. Mr. Ricciardi, do you want to ask some
4 questions? Should I -- I'm just looking for an opinion?
5 Is it a good time for a break. It's 5:00 o'clock.

6 THE WITNESS: It is.

7 THE COURT: Let's take ten or so. Make it 15.
8 Make it 5:15.

9 (A break was held.)

10 THE COURT: We're back on the record. I had a
11 little off-the-record discussion before that if we're done
12 with Dr. Knutson before too long, like 6:00 o'clock or so,
13 that I'd ask Mr. Yale to have another witness to be ready
14 to testify. I'd like to go close to around 7:00 o'clock
15 tonight, and I'd like to go from 8:00 to 11:00 tomorrow.
16 8:00 a.m. to 11:00 a.m. tomorrow, and wrap it up.

17 So, at this point, Mr. Ricciardi, I think was
18 about to recognize you to ask questions, right? Come on
19 up.

20 EXAMINATION

21 BY MR. RICCIARDI:

22 Q. Dr. Knutson, good evening.

23 A. Evening. Well not quite.

24 MR. UNIDENTIFIED: Not good or not evening.

25 Q. (By Mr. Ricciardi) Evening somewhere. In your

1 position at Texas A & M, and as a dairy economist, do you
2 review certain publications in the dairy industry on an
3 ongoing basis?

4 A. I do, yes.

5 Q. One of the things that you attempt to do is to
6 keep abreast of what's going on in the various markets in
7 the federal order system?

8 A. I do, yes.

9 Q. And is one of the areas that you have attempted
10 to at least keep up-to-date on the Arizona Las Vegas or the
11 131 area?

12 A. Yes.

13 Q. You indicated that that was a highly concentrated
14 market and I think you gave Mr. Berde the reasons for that.
15 In fact, in Exhibit 6 Table 1 indicates that there are four
16 handlers operating pool plants, Kroger and Safeway, was
17 that the two vertically integrated handlers that you were
18 talking about?

19 A. Yes.

20 Q. And Shamrock was the larger independent you were
21 referring to?

22 A. Yes.

23 Q. And the coop that you were referring to when you
24 answered Mr. Berde's question was United Dairymen of
25 Arizona?

1 A. Yes.

2 Q. Why do you say, given the information in Exhibit
3 6 that you already testified to, based upon your
4 independent knowledge, that that is a highly concentrated
5 market?

6 A. Well, you know, really for a number of reasons.
7 Clearly, on the producer side it's highly concentrated.
8 You've got one major coop serving the market, which is not
9 unusual. You've got only two -- you've got two vertically
10 integrated chain stores that are dominant in the market.
11 And then you've got one dominant independent processor.
12 That is a classic example of what I referred in my
13 testimony as trilateral oligopoly to the extreme, almost
14 trilateral monopoly in the market.

15 So it's clear enough to me that this is a very
16 highly concentrated market.

17 Q. And if you have a highly concentrated market like
18 the one you've described in 131, what's the potential
19 impact on the consumer, in terms of milk pricing?

20 A. Well, the potential impact is clearly that the
21 consumer can end up paying considerably higher prices for
22 milk.

23 Q. And why is that?

24 A. Well, because you've got a coop that has no
25 competition. You've got two chain stores that are

1 processing their own milk in the market that are dominant
2 factors. And then you've got one large independent
3 processor that's dominant. It's not unreasonable to
4 anticipate that without outside competition, that these
5 guys are going to be very good at coordinating pricing
6 activities.

7 Q. And let's talk about the issue of consolidation
8 in the dairy industry that's been occurring over the last,
9 and let's pick the last three to five years.

10 Has there been more or less consolidation in the
11 time frame that I just asked you about?

12 A. You have to pick each segment. You have to look
13 at the coop segment and the consolidation in the coop
14 segment really occurred before the last four or five years.
15 But it's been dramatic if you look at say the last 15
16 years. It's been dramatic.

17 The consolidation on the processor side is indeed
18 more representative of being the last four or five years
19 with the consolidations involving Dean's and national
20 holding company. That has been extensive.

21 Vertical integration by chains has been
22 relatively static as I see it. There's -- you know, there
23 were a lot of plants that were built some time ago by
24 chains and we've not -- my perception is that we've not
25 seen any real substantial increase. But what we have seen

1 is that a lot of regional chains have been purchased by
2 Kroger, by Safeway probably not as much by Albertson,
3 although probably by Albertson as well in the past, in the
4 recent past. And sometimes you don't see it readily
5 because those chains have kept the regional's name by
6 virtue of the fact that they have brand identification on
7 the part of consumers.

8 Now, undoubtedly, they supply those chains
9 through their own plants to a significant extent. So
10 therefore, you know, in that sense, there's been
11 consolidation at the retail level, as far as milk
12 processing is concerned too.

13 Q. In staying with this topic, I notice that in your
14 testimony that you refer to the concept of monosynopy, what
15 is that?

16 A. Single buyer.

17 Q. And has that -- that is monosynopy increase in
18 power of monosynopy and occurring over the last several
19 years in the milk area?

20 A. Oh, yes, absolutely.

21 Q. And tell me what, if you know, national chains or
22 other larger companies that have been involved in the
23 monosynopy process.

24 A. Well, national chains certainly, large -- Dean
25 and national holding companies certainly are a part of that

1 issue, at somewhat a different market level. If you want
2 to go to the producer level, I mean, there's monosynopy as
3 far as coops are concerned and buying milk from producers,
4 having relatively few alternative sources of milk supply,
5 and not being subject to the same level of regulation
6 either.

7 Q. Same issue I noted in your statement, your
8 footnote, footnote one, in which you cite to a cheese
9 reporter from October 31, 2000, regarding Senate hearing
10 looks at power of monosynopy buyers and dairy industry, do
11 you recall that article?

12 A. Yes, I do.

13 Q. That article indicates that Dean Foods now
14 controls more than 30 percent of all milk production
15 nationally. Is that your understanding?

16 A. Well, you know, by citing it, I don't necessarily
17 say that I subscribe to everything that's in that article.
18 The -- to say they control X percent of production is
19 obviously not the case. It's processing. You know, they
20 process a certain percentage of the milk, and whether that
21 specific number is completely accurate or not, I'm not
22 sure.

23 The point is, that the issue of market power in
24 the dairy industry has clearly gotten -- is getting
25 national attention and is one that policy makers should be

1 concerned about. That's my purpose in citing it.

2 Q. Senator Leahy (phon.) is quoted and I'm going to
3 quote him as saying, our farmers are not getting a fair
4 share of the retail price of milk, while giant corporate
5 processors are taking in our competitive profits as they
6 simultaneously raise prices to consumers.

7 Do you agree with those statements?

8 A. Well, I don't know. You know, if you look at the
9 milk industry, you know, you'd have a difficult time as in
10 any agricultural industry verifying that extraordinary
11 profits are being made in the system. And part of that is
12 because I would argue that to a degree, we have a
13 regulatory system that's designed to foster competition,
14 and I think the producer/handler or regulation is one of
15 those elements of that.

16 And I can understand why interest groups, frankly
17 I have a problem understanding why producers interest
18 groups take this position, but I can understand why
19 processors, whether they be a chain store or an independent
20 processor might want to get rid of the producer/handler
21 exemption. I mean, you know, it makes sense. That's
22 competition for them. But I can also understand that it
23 would be difficult for me to see a Secretary of
24 Agriculture, although I'm certainly advising her on what to
25 do, I can't tell her what to do, it would be difficult for

1 me to see a Secretary of Agriculture want to stifle an
2 important source of competition, in an industry that's
3 undergoing substantial structural change toward increased
4 concentration.

5 So, you know, I'm not going to get bound up in
6 the political rhetoric that goes on Capital Hill with
7 respect to this issue of concentration. But I am certainly
8 concerned that we not change the playing field to put
9 people out of business that are competitors in the
10 marketplace.

11 Q. I understand. Let me switch gears for a little
12 bit and ask you some more questions about the milk industry
13 in general.

14 In terms of loss of customers for milk products,
15 is service an important issue for a customer in terms of
16 making a decision whether to maintain a relationship with a
17 provider of a dairy product like fluid milk?

18 A. Oh, certainly, yes.

19 Q. In what way?

20 A. Well, you know, service in the sense of being
21 willing and able to provide product in the form and at the
22 time and of the quality that is desired by the firm. I
23 think, you know -- I haven't heard testimony from firms
24 like Wal-Mart or Costco, but I'm sure they look to a
25 producer/handler to supply them with milk, because

1 producer/handlers are in a perfect position to supply them
2 with a product. I mean, it's a perfect niche market for
3 the producer/handlers.

4 Q. We've also heard some testimony that you weren't
5 privy to, but I want to ask you about the concept. That
6 the ideal of a single source of milk at both the marketing
7 -- at both marketing by a producer/handler and ultimately
8 the customers interest is important or has become important
9 recently.

10 Do you know anything about single source milk and
11 the importance both on the marketing side and to a
12 customer?

13 A. Well, I think that, you know, consumers,
14 processors are concerned in an age where a source of supply
15 is very important. Terrorism is very important. They're
16 concerned about traceability and be able to trace the
17 origin of milk supply is very important.

18 More important than it's ever been in the past to
19 both the consumer and as a result, to the processor. So
20 being able to trace exactly where that milk came from,
21 having assurance that it is a fresh product. In some cases
22 for some consumers knowing that it was produced without
23 RBST, those are relevant and important considerations.
24 More important than they have been in the past.

25 Q. Okay. One of the positions advocated by the

1 proponent during the course of this hearing that you may or
2 may not have heard, is the claim that somehow the regulated
3 handler cannot compete with the producer/handler on price
4 with regard to certain customers, including the warehouse
5 stores and others.

6 I noted that you had in your testimony this
7 Inland example and Starbuck's and Safeway. Why is that
8 important?

9 A. Well, it's important because it indicates that
10 indeed they can compete on the basis of price. They have
11 been competitive on the basis of price and I'm sure that
12 it's not been -- the only example that one could come up
13 with, but it's a striking example and it's a clear case
14 where even though the exemption from Class One pricing and
15 pooling exists, Safeway has seen the ability to go in and
16 compete and take away that account.

17 Q. And let me share with you an exhibit that you
18 haven't seen, but I'm going to ask you to make some
19 assumptions and I'm going to read, for my purposes of my
20 questions on this.

21 During the course of the hearing in Phoenix,
22 Shamrock had presented an exhibit, Exhibit 22, which is
23 headed Sarah Farms gallon volume estimated by account
24 monthly estimates. I think it was Mr. Kruger who testified
25 about it. And I'm not asking you to accept that it is

1 true, but only asking you as often happens in these
2 hearings to make certain assumptions.

3 There are certain footnotes in that exhibit which
4 indicates, for example, at footnote five that Sarah Farms
5 had served Wal-Mart for a period of time from '99 to 2000
6 and Ador (phon.) Farms served them in 2001 and Shamrock
7 served them from 2002 to the present.

8 Now, Shamrock is a regulated handler. If, in
9 fact, it couldn't compete on price with Sarah Farms, would
10 you expect to have a situation where Sarah Farms apparently
11 lost an account and Shamrock got it?

12 A. No, you would not expect that.

13 Q. Why not?

14 A. Well, because you know, the contention is that
15 these guys are not competitive as a result of the
16 exemption. That clearly that they can be competitive.

17 Q. There's also an indication at footnote six about
18 another smaller account that ultimately moved their
19 business to Shamrock. Shamrock claims and I'm asking you
20 to assume it, not that it's a fact, but it's an assumption,
21 that it was because of service and quality issues, and that
22 leads me to two questions.

23 First of all, is price always the key issue to a
24 customer with regard to its purchase of milk?

25 A. No, it's not. I mean, that's clear enough from

1 my discussions with the producer/handlers and from past
2 experience.

3 Q. And second, if in fact, the regulated handler
4 couldn't compete with the producer/handler on price for all
5 of the accounts, would you expect to be seeing switching
6 from producer/handlers to regulated handlers?

7 A. No, it would not.

8 Q. Then there's actually another one in footnote
9 nine, Food Fer Less, which I think is no longer in
10 business, but it serves our example because the assumption
11 is that Shamrock had the business, lost the business to
12 Sarah Farms, and then got it back.

13 Again, in addition to your Starbuck's example
14 from their own exhibit, we've got more examples that price
15 is not the key thing, right?

16 A. Yes.

17 Q. And that they obviously can compete on price,
18 right?

19 A. Yes.

20 Q. Now, certain questions that Mr. English asked you
21 and bear with me, I'm not going to yell at you, so if in
22 fact, you can't hear me, I'll speak up, okay?

23 A. Okay.

24 Q. I want you to make certain assumptions, okay?

25 I want you to assume that everything eh told you

1 as testified to by Mr. Kruger regarding pricing and
2 benchmarking and direct cost and all that other business
3 that he asked you about. It's not true, but I want you to
4 assume it to be true. Okay.

5 A. Uh-huh.

6 Q. Does that change any of your opinions as to
7 whether or not there is evidence of disorderly marketing in
8 131?

9 A. Absolutely not.

10 Q. I also want you to assume not as a fact, but as
11 an assumption that Exhibit 22 which shows Sarah Farms'
12 perceived gallon volume estimates by account from '97
13 through 2003, again put together by Shamrock. Their
14 estimates show that the gallon volume is not poundage, of
15 course, it's gallons, goes from about 196,000, a little bit
16 more than that in '97 through 2003, a little over 2
17 million. Okay. Assume that to be true.

18 That type of growth in a concentrated market, as
19 reflected in Exhibit 6, and as you have knowledge based
20 upon your experience in the industry, does that in itself
21 show either some type of unfair advantage or second
22 question, disorderly marketing?

23 A. Absolutely not.

24 Q. Why not?

25 A. Well, you know, if you look at all of the

1 conditions that have changed in the milk market, combined
2 with, you know, the evolution of producer/handlers, they --
3 and the policy change, they all help to explain, you know,
4 that opportunity and the increased opportunity that exists
5 on the part of producer/handlers in the market, to expand
6 market share.

7 Q. And I guess I don't understand it, so I'm going
8 to ask some questions about it, and I think it might've
9 been Mr. Berde that was asking these questions.

10 If in fact that a producer/handler is an
11 efficient operation, okay; if in fact, they're integrated
12 as you've testified about; if in fact, they find a market
13 niche; and you have a concentrated market like 131. Would
14 you anticipate, given those circumstances, that a
15 producer/handler would grow?

16 A. Absolutely.

17 Q. And as I understand the position by the
18 proponents, it is the very growth and efficiencies and
19 success that makes them now under their proposal, subject
20 to a three million dollar ceiling because they've now
21 become competition.

22 A. Yes, I agree.

23 Q. Does that make any sense to you?

24 A. It makes absolutely no sense at all, not from a
25 regulatory standpoint.

1 Q. Does it make any sense to --

2 A. It makes no sense to put a volume limit in our
3 legal framework, as a general principle. Volume limits are
4 -- first of all, they have no basis economically for them.
5 They're purely arbitrary. And they're mechanical. They're
6 not based upon results in the marketplace.

7 Q. Okay. And you've now jumped to the area I wanted
8 to go to.

9 This proposed volume limit of three million
10 pounds per month, you have reviewed the experts from the
11 proponents' side and the reasons that they have given, as
12 to why that volume limitation has some basis. Can you tell
13 us now and tell the Secretary, is there any real factual or
14 policy basis for trying to set a limit on producer/handlers
15 at three million pounds a month?

16 A. Absolutely not.

17 Q. And why not?

18 A. Well, there's been no testimony that has been
19 presented that indicates that that has any relationship to
20 the purpose of federal orders related to disorderly
21 marketing. I mean, it just isn't there. And so if it
22 isn't there, then you know, certainly the limit doesn't
23 make any sense. But why you would set it at three million
24 pounds is absolutely beyond me. But in addition, why you
25 would set it at any limit is unclear to me, in light of the

1 fact that, you know, aside from this one instance in one
2 market, where you got very high levels of concentration,
3 there's been an increased market share.

4 Q. Does increase in market share equate to
5 disorderly marketing?

6 A. Absolutely not. It has -- it equates to
7 increased competition.

8 Q. Next question. If a regulated handler loses a
9 customer to a producer/handler because of problems that
10 that customer had with quality or service of the regulated
11 handler, is that evidence of a disorderly marketing?

12 A. No, absolutely not.

13 Q. Do people change from producer/handlers to
14 regulated handlers?

15 A. Yes.

16 Q. Do customers go from regulated handlers to
17 producer/handlers?

18 A. You demonstrated that in the table on the exhibit
19 that you referred to.

20 Q. It happens all the time.

21 A. It happens all the time.

22 Q. If -- and by the way, do customers sometimes tell
23 suppliers of milk that they're getting a better price than
24 they're actually quoting?

25 A. Oh, sure.

1 Q. Why?

2 A. To beat down the price.

3 Q. That happens in every industry?

4 A. Sure it does.

5 Q. Whether it may be true or may not be true, right?

6 A. Right.

7 Q. If, in fact, there's a loss of a customer by a
8 regulated handler to a producer/handler based upon
9 perceived price, a decision by the regulated handler
10 doesn't want to go below a certain price, a decision by the
11 producer/handler that he can give an efficiency to go to
12 another price, maybe below what the regulated handler is
13 willing to sell for, is that an example of disorderly
14 marketing?

15 A. No.

16 Q. Why not?

17 A. You know, that's part of regular competition in
18 the marketplace. It's just the reality of the markets.

19 Q. Anything you want to add based upon the cross-
20 examination that you've had so far and the examination that
21 I have had of you so far?

22 A. No.

23 Q. Thanks.

24 THE COURT: Mr. Yale, do you want redirect or do
25 you want to give him another round?

1 MR. YALE: Let them. They might even ask my
2 question. I doubt it, though.

3 THE COURT: Go ahead, Mr. English.

4 EXAMINATION

5 BY MR. ENGLISH:

6 Q. Charles English for Dean Foods and Shamrock
7 Foods.

8 Well, there's certainly been a lot of discussion,
9 sir, about Safeway and Shamrock. I'm sorry, Safeway and
10 Starbuck's, but you haven't actually investigated why
11 Edaleen Dairy lost the business of Starbuck's and Safeway,
12 have you?

13 A. No, I have not.

14 Q. It could be something other than price, couldn't
15 it, sir?

16 A. Oh, sure it could.

17 Q. Are there Safeways in Colorado these days?

18 A. Oh, yeah.

19 Q. You live in Colorado, right?

20 A. Well, sort of. About half of the time.

21 Q. Do you ever go to Safeway?

22 A. Regularly. It's the only option we have.

23 Q. There you go.

24 A. It's a perfect example of monopoly.

25 Q. There you go. When you go in your Safeway, are

1 you a coffee drinker?

2 A. Yes.

3 Q. Have you noticed that Safeway in your Colorado
4 store carries Starbuck's?

5 A. Oh, absolutely. I even buy some of it.

6 Q. Has it occurred to you, based upon that, since
7 you haven't done any other investigation, that the real
8 reason that Starbuck's switched to Safeway had nothing to
9 do with price, was because Safeway where ever it is
10 located, on a national basis, has a contract with
11 Starbuck's?

12 A. Yeah, that's occurred to me but that indicates,
13 you know, that Safeway can compete despite the exemption.
14 Beyond that, I've noticed that Albertson will have
15 Starbuck's in it as well, frequently, in markets where
16 Safeway exists, so that's rather interesting. It's not a
17 one-way street.

18 Q. Do you know whether Starbuck's has done a joint
19 venture with Safeway and is actually putting little coffee
20 boutique operations in Safeway stores nationwide?

21 A. In fact -- I don't know it nationwide, but I've
22 seen coffee boutiques in Albertson stores.

23 Q. Now, you had some discussion about single buyer,
24 and you've commented on how you've investigated from afar
25 the Arizona/Las Vegas market.

1 Are you aware of what other milk supplies are
2 available to the Arizona market?

3 A. What other milk supplies.

4 Q. Other than -- you mentioned UDA. Do you ever
5 hear of other milk supplies?

6 A. In other than the producer/handlers is that --

7 Q. Other than the producer/handlers or the UDA.

8 A. No, I'm not.

9 Q. So if there's another coop operating in that
10 market, you're not aware of it?

11 A. I've not got that detailed information, no.

12 Q. And if there's milk coming in from California,
13 you're not aware of that?

14 A. I'm aware that there's an issue both ways between
15 California and Arizona.

16 Q. Both ways that there's milk that can go from
17 Arizona, that would otherwise be surplus to Arizona, it can
18 go into the California market, correct?

19 A. Yes. Yes.

20 Q. And when it's disposed of in the California
21 market, however it gets there, it can receive a price based
22 upon the California market-wide pool, correct?

23 A. Yes.

24 Q. And you had some discussion about the idea that
25 there are three regulated plants in addition to the

1 producer/handler in the Arizona/Las Vegas market, correct?

2 A. Three big ones, yeah.

3 Q. But, of course, there's plants outside of the
4 Arizona market that sell in, correct?

5 A. Oh, yeah, that's quote possible.

6 Q. And in your investigation that you've done, what
7 percentage of the milk comes in from outside?

8 A. I don't know the answer to that question.

9 Q. And, of course, you're aware that there's another
10 fluid milk processing plant in Arizona/Las Vegas that
11 doesn't show up on these charts?

12 A. No, I'm not aware of that.

13 Q. You in keeping grasp of the Arizona/Las Vegas
14 market, you're not aware that there's a fluid milk
15 processing plant located in the Arizona/Las Vegas marketing
16 area that isn't anywhere listed as a fully regulated plant
17 or producer/handler or volume from another plant?

18 A. No, I'm not aware of that.

19 MR. ENGLISH: Thank you, sir.

20 THE COURT: Mr. Berde.

21 EXAMINATION

22 BY MR. BERDE:

23 Q. Dr. Knutson, did you refer Kroger and Safeway as
24 vertically integrated?

25 A. Yeah, they process and retail their own milk.

1 That's a different form of vertical integration than the
2 producer/handler.

3 Q. You are not suggesting they are vertically
4 integrated with respect to the issue that is before this
5 hearing?

6 A. No. No.

7 Q. And you also talked about the effect of
8 concentration as having an impact on consumers in Arizona.
9 Have you studied the out of store prices of milk in Arizona
10 as in comparison to out of store prices in other marketing
11 orders in which the differential is lower than Arizona?

12 A. I have referred to in my testimony, Mr. Berde,
13 the fact that Arizona retail prices sit at about the
14 average level of other markets.

15 Q. Yeah. Are you aware that in spite of the so-
16 called concentration, the out of store prices in Arizona
17 for milk are lower than the out of store prices in the
18 Minneapolis/St. Paul market, which has a 1-60 differential
19 as compared to the Arizona differential?

20 A. Oh, that may be the case, and it may be in part,
21 a result of producer/handler competition.

22 Q. Are you aware that -- of any producer/handlers in
23 the Minneapolis/St. Paul area?

24 A. No, I'm not. No, I'm not.

25 Q. Are you aware that there are none?

1 A. I believe that.

2 Q. So that the fact that there are three major
3 competitors in Arizona has had no effect whatsoever in
4 terms of creating higher shelf prices in Arizona, as
5 compared to other markets?

6 A. It may be equally the case that the
7 producer/handler factor in that market, has been the
8 competitive force in that market.

9 Q. Well, but your statement was that that market has
10 a high -- such a high concentration that it has some impact
11 on consumers.

12 A. In the absence of producer/handlers it would.

13 Q. Are you aware that even prior to the entrance of
14 this substantial producer/handler, the out of store prices
15 in Arizona has always been below the out of store prices in
16 other areas of the country with lower differentials?

17 A. Well, I'm not arguing that it might not be lower.

18 Q. The fact is, you haven't studied the issue, have
19 you?

20 A. I have studied the issue.

21 Q. And what did you find?

22 A. I found that differentials in Arizona just as I
23 indicated, you know, are about the average for the country
24 as a whole.

25 Q. Are you --

1 A. Major markets and that's what the USDA data
2 suggests.

3 Q. Have you ever, in fact, made a study to compare
4 out of store prices in Arizona with out of store prices in
5 other areas of the country having lower differentials?

6 A. Yes, I've done it across markets.

7 Q. And what did you find?

8 A. I found that they're about the average level.

9 Q. That if they're the average level with a higher
10 differential, then there could not have been an impact of
11 concentration raising consumer prices in Arizona, could it?

12 A. As I said, simply because you've got
13 producer/handler competition in that market, could well be
14 a key factor.

15 Q. I'm talking about a time when there was no
16 producer/handler competition in Arizona, have you ever made
17 a study during that period?

18 A. I can't. I'd have to go back and look. No, I've
19 not looked at ancient history.

20 Q. You also talked about monosynopies and did I hear
21 you refer to a cooperative as a monosynopy?

22 A. In buying from producers, yes.

23 Q. All right. Is it your understanding that a
24 cooperative buys milk from its producers?

25 A. Sure it does.

1 Q. Sure it does?

2 A. It certainly does.

3 Q. Is that the nature of a cooperative structure,
4 that it buys milk from --

5 A. It buys milk from the producer. It buys it and
6 markets it.

7 Q. Where do you find in any relationship --

8 A. Pays the price.

9 Q. Where do you find it in any relationship in the
10 cooperative marketing agreement that a cooperative buys
11 milk from its members?

12 A. It buys it in the sense that it pays a price, it
13 takes control of the milk and markets it.

14 Q. Are you unaware that a cooperative is simply an
15 agent for its producers?

16 A. I'm not unaware of that theory.

17 Q. And are you unaware that no one familiar with
18 cooperative operation has ever suggested that a cooperative
19 buys milk from its members?

20 A. That's malarkey, I don't believe that. No one
21 has ever suggested that, you know.

22 Q. Well, I'm suggesting that that's what the
23 contract between the cooperative members says.

24 A. Okay. Okay.

25 Q. And that's the manner in which a coop operates.

1 A. Well, but it does buy milk. It does take control
2 of the milk.

3 Q. Oh.

4 A. It does pay a price.

5 Q. Oh, it takes control of it -- does it have to pay
6 any particular price?

7 A. No, no, that's one of the benefits a cooperative
8 has. I mean, if you want to create a level playing field,
9 then you'd take away that benefit from cooperatives. If
10 you're really concerned about a level playing field.

11 Q. If someone buys a product from another, isn't
12 there ordinarily a price stated at which the buyer will pay
13 the seller?

14 A. Not necessarily.

15 Q. Oh, there isn't?

16 A. Not necessarily is that always the case that
17 there's a stated price in advance.

18 Q. There is some basis to establish a price, either
19 by formula or otherwise.

20 A. And there is in a cooperative, too.

21 Q. What is the formula.

22 A. It's the pool price, minus some costs associated.

23 Q. Any particular price?

24 A. Not a particular price, no.

25 Q. It vary to what's available.

1 A. It can vary, yes.

2 Q. And you call that a purchase?

3 A. Yes.

4 Q. Huhhh, huhhh.

5 THE COURT: Is there anymore cross-examination
6 and then I'm going to ask -- oh, go ahead, Ms. Deskins.

7 EXAMINATION

8 BY MS. DESKINS:

9 Q. Charlene Deskins, Office of General Counsel,
10 USDA.

11 Sir, you were asked a question by Mr. Ricciardi
12 where you said that you didn't believe there should be any
13 limit based on the three million pounds that's in the
14 proposals. And I was wondering if a limit were based on
15 something other than say, a strict poundage amount, would
16 you think that would be appropriate?

17 A. No, I don't know, you know, aside from just
18 prohibiting outright, you know, producer/handlers any
19 differential. I don't know how you would devise such a
20 limit.

21 The whole notion of saying there's certain firms
22 that qualify and certain firms that don't qualify is --
23 it'd have to be purely arbitrary. I don't know. I don't
24 know how you'd come up with a limit on an objective basis.
25 Surely you don't want to do it for an individual firm.

1 Selectively. Say this firm is subject to it and that one
2 isn't. That doesn't make a whole lot of sense.

3 So, you know, I've thought about this a fair
4 amount in terms of -- you know, this is a policy issue in
5 general. There's payment limits in farm programs. They're
6 purely arbitrary as to where you set them. And they make
7 no sense from an economic standpoint, from a competition
8 standpoint, from an efficiency standpoint.

9 So, you know, I don't know how if you wanted to
10 set some kind of an objective basis, I would suspect that
11 these guys would've come up with it. But the fact that
12 they just come up with the three pound limits, suggests
13 that there probably is no really objective way to do it, if
14 you want to do it, and I don't know why. I don't know why
15 you'd want to penalize efficient firms from competing in
16 the marketplace.

17 MS. DESKINS: I don't have any other questions.

18 THE COURT: Okay. Mr. Ricciardi has a question
19 or two?

20 MR. RICCIARDI: I apologize, Your Honor, but Al
21 Ricciardi on behalf of Sarah Farms.

22 There was a question asked that I want to follow-
23 up on, Judge.

24 EXAMINATION

25 BY MR. RICCIARDI:

1 Q. Dr. Knutson, you used the phrase and answer to
2 Ms. Deskins' question, selective limitation. Why do you
3 see this as a selective limit?

4 A. Because there's no rational basis that's been
5 explained for that limit. I mean, there's no objective
6 basis. It's selective in that it's designed to say, you
7 know, you get to a certain size and then you have the
8 potential for taking accounts from somebody else, and we
9 don't like that. I mean, that that's unfair competition.
10 And I just don't believe that that's unfair competition.

11 I mean, there is no logical basis for setting the
12 limit.

13 Q. Let's go from the issue of a selective
14 limitation, that is, this arbitrary three million dollar
15 ceiling to the issue of selective enforcement. Isn't this
16 really an attempt to selectively enforce against the
17 producer/handlers that are successful?

18 A. Sure it is, absolutely. Absolutely.

19 MR. RICCIARDI: Thank you.

20 THE COURT: Go ahead, Mr. Yale.

21 MR. YALE: Are you sure?

22 THE COURT: I'm sure if you're sure.

23 EXAMINATION

24 BY MR. YALE:

25 Q. I think it is start to get evening, Dr. Knutson,

1 so good evening.

2 A. It is now -- well, one minute.

3 Q. By the way, I do want to thank you on behalf of
4 my clients, Smith -- on behalf of Smith Brothers Farms and
5 Edaleen Dairy, Mallory's, and I'd like to thank you for
6 providing your testimony.

7 I do have one. After looking a little more
8 carefully at your curriculum vitae and I got one concern,
9 but I'll forgive that, and is that, is your alma maters
10 have not been very good to my Buckeyes. Your Minnesota
11 guys did not stop Michigan, and they can't hold out. And
12 your Aggies didn't even show up on the ball field.

13 A. Oh, gees, the Aggies have had a terrible season,
14 so has Nebraska.

15 Q. Yeah. It's --

16 MR. UNIDENTIFIED: This is the point where I
17 start sitting on the other side of the room.

18 (Group comments.)

19 Q. (By Mr. Yale) I want to -- there's just a few
20 areas here that I kind of want to focus on. And one of
21 those is this issue of a level playing field, and I kind of
22 want to come off this football analogy, and that is, that
23 if you've got a quarterback that's really good at passing,
24 and you play a team that has a quarterback that's not good
25 at passing, is that because the playing field's unequal, or

1 is it because somebody has chosen to use the rules to take
2 advantage of what they have?

3 A. The latter.

4 Q. Now, in this marketing order and these
5 producer/handlers and you've looked at these regulations,
6 you understand you produce all the milk, and you market all
7 the milk you produce in simplistic terms. Is the decision
8 -- the level playing field initially begins, does it not,
9 at the decision of a plant to decide to be a regulated
10 handler that pays minimum prices, or a regulated
11 producer/handler that doesn't pay it, right?

12 A. Right.

13 Q. That's the decision, right?

14 A. Right.

15 Q. And is there anything in these regulations,
16 anything in the regulations that favor any group over
17 another to make that decision?

18 A. No.

19 Q. Now, doesn't that make that a level playing
20 field?

21 A. I would argue it does, yes.

22 Q. And, in fact, when they make that decision, they
23 have to weigh not just this difference between a Class One
24 price and some other price, right? They have to look at
25 their total inter-price, is that correct?

1 A. Exactly, yes.

2 Q. And that includes risk. It includes capital. It
3 includes management. It includes a lot of things other
4 than price, right?

5 A. Yep. Yes.

6 Q. Is there anything in these regulations that say
7 someone, a big huge, maybe 50 percent of the market, or 30
8 percent of the market can use its capital and expertise to
9 be a PD, it cannot use it because it's big?

10 A. There is nothing.

11 Q. All right. And doesn't that make that -- isn't
12 that the definition of a level playing field?

13 A. Yes.

14 Q. And, in fact, what even also goes on this is that
15 as you understand these rules, that these changes on a PD
16 can be from month-to-month, right?

17 A. Yes.

18 Q. So there's nothing that somebody says, I'm going
19 to build a plant today and they have to make a lifetime
20 commitment to be fully regulated at minimum prices, right?

21 A. Yeah.

22 Q. That allows for efficiency in the system to go
23 back and forth, right?

24 A. Yes.

25 Q. Now, you're an economist and I may use the wrong

1 term, and trust me, in the way I'm feeling right now, I'm
2 probably going to use a lot of wrong terms before this is
3 over with the rest of the night.

4 But arbitrage, what's arbitrage? What's one of
5 the concepts of arbitrage that --

6 A. It's the ability to take a differential that
7 exists in the market and capture that differential through
8 competition.

9 Q. And one of the things that happens when you
10 capture that differential, in a fully efficient market, is
11 that -- is what? I mean, ultimately --

12 A. The market becomes more efficient, more
13 competitive, more -- the result is more and the interest of
14 the general welfare of society in general.

15 Q. And don't you also reach an equilibrium?

16 A. Absolutely.

17 Q. Now, in these producer/handler regulations and
18 the definition and the way that the Department has enforced
19 them over these years, is there anything in here that
20 indicates that there is an interference because of
21 regulation in the ability of this arbitrage to work and the
22 idea of a plant to be a PD or not a PD?

23 A. There is nothing in there.

24 Q. Now, isn't that the perfect example of a level
25 playing field?

1 A. Yes.

2 Q. Isn't that a perfect example of regulations that
3 are not interfering with the marketplace, right?

4 A. Yes.

5 Q. And, in fact, if they're truly -- I think your
6 testimony was, if there truly was some special advantage
7 there, that it would attract more participants.

8 A. You'd see a lot more PD volume than there is.

9 Q. And have you seen in the last three or four
10 years, any change in the circumstances in the marketing
11 conditions that would support -- that are different today
12 than they were three or four years ago to allow a person to
13 be a producer/handler? I mean, do the market conditions --
14 I've got to withdraw that. Like I said, I'm going to have
15 some problems here.

16 If you take the market conditions in the last
17 four years, is there anything now that's -- that makes the
18 ability of a plant to choose to go back and forth, any
19 different than it was four or five years prior to those
20 four or five prior years ago?

21 A. No. I pointed out the impact of federal milk
22 market order reform on the process. And certainly that's
23 been a factor, but to -- other than that, I don't see
24 anything.

25 Q. But that created, I think your testimony was,

1 because particularly the higher of and everything --

2 A. Yes.

3 Q. -- there's a greater economic incentive.

4 A. Yes.

5 Q. It didn't change ability of an operation to make
6 a decision what they wanted to do.

7 A. No, no.

8 Q. All right. And it didn't change the risk of
9 being a fully integrated handler, did it, in terms of the
10 risk of loss, you know, that it encounters with --

11 A. A fully integrated handler, you're talking about
12 a producer/handler.

13 Q. Yeah.

14 A. No, it did not.

15 Q. Now, you mentioned this payment limitations in
16 the prior programs and I think the question that -- an
17 answer to question by Ms. Deskins about limits, and how
18 they end up being arbitrary, right?

19 One of the problems, is it not, with limits in
20 farm programs, is that it creates a bump, so to speak, in
21 the movement of an entity going from one size to another,
22 right? Because at one point they're getting the full
23 benefit of a particular program, they hit that limit, and
24 then all of a sudden, their contribution from the
25 government in one way or another changes, right?

1 (Contractor's Note: The following proceedings were held
2 after 6:00 p.m.)

3 A. Yeah.

4 Q. And so what is --

5 A. Or you get a whole bunch of inefficient firms
6 that are just under the limit, which doesn't make any
7 sense.

8 Q. Which breaks up my point, that doesn't that start
9 to create a situation where people begin to make decisions,
10 business decisions, to establish a size of operation that's
11 independent of the efficiencies of an efficient
12 marketplace, but only in response to a size establishing
13 it.

14 A. Exactly.

15 Q. And is that creating orderly marketing?

16 A. It certainly isn't.

17 Q. Is that creating a level playing field?

18 A. No.

19 Q. Now, I want to take you to -- and I really hope I
20 can keep this under control. I don't want to go through
21 the deal with Mr. English and Mr. Berde about the law and
22 all that other, but there's a point I want to bring out,
23 and there's a phrase in the statute that says, a producer
24 who acts as a handler, right? I think you've seen that
25 language or heard that, right?

1 A. Yes.

2 Q. Now -- in its capacity as a handler.

3 Now, does that equate necessarily to the
4 producer/handler we're talking about today? Or let me ask
5 it this way --

6 A. I don't follow the question.

7 Q. Let me -- I told you, this is going to be a
8 problem, and I'm going to try and make myself clear. I'm
9 still speaking English, right? Okay. Tell me when I'm not
10 and it's time to quit.

11 If we take a producer -- isn't it possible for a
12 producer to -- we already know we can be a
13 producer/handler, right? They can be --

14 A. Correct.

15 Q. But a producer that is a handler also could not
16 have some regulatory impact, and I don't want to get to
17 that, but a producer who is selling to a handler, right --
18 or not selling to a handler, a producer who is a handler,
19 can also act as a handler of other producers' products --
20 other producers' products, right?

21 A. Uh-huh. Uh-huh.

22 Q. So producer A can integrate with a plant and
23 become producer/handler A and then producer A can producer
24 -- can act in the capacity as a handler, to acquire milk
25 from another producer, right?

1 A. Right.

2 Q. And it's not the same thing as the
3 producer/handler we're talking about?

4 A. No, it certainly isn't.

5 Q. Now, there was some questions about -- there were
6 some questions about the use of -- or bringing up some
7 examples of handlers in the marketplace. I think, for
8 example, one of them that was mentioned was Anderson here
9 in the northwest and I think there was a suggestion of one
10 elsewhere, I can't remember now, it escapes me.

11 And the question was, should they have to pay for
12 their milk under your purchase theory and, you know, the
13 things you've been mentioned about whether it's being
14 purchased or not. Do you recall those discussions?

15 A. Yes.

16 Q. All right. Now, you would agree, would you not,
17 that if you are a producer acting as a handler, both of
18 your own milk and someone else's, that there's no doubt
19 about it that the Secretary has the authority and maybe
20 even the obligation in a regulated market, to impose
21 minimum prices as that handler purchases from the other
22 producers, right?

23 A. Absolutely.

24 Q. And it may not have to require from paying or
25 doing some accounting mechanism for the milk that it

1 already owned in its operation, right?

2 A. Right.

3 Q. So the obvious question comes, why in the world
4 are we having handlers that are in that situation that are
5 paying on all their milk, right?

6 Now, I want to give you an example, to try to
7 keep this simple. That you have an handler that has an 80
8 percent Class One utilization. But it also has 20 percent
9 of its own supply of milk.

10 Now, it would not be -- you understand the --
11 (Tape change.)

12 -- that handler count -- well, let me ask it. Do
13 you know understand what I mean by the term down allocate?

14 A. Yes.

15 Q. And what is down allocate?

16 A. Down allocation is paying to a lower price.

17 Q. Right. So it could down allocate --

18 A. Lower class price.

19 Q. A lower class. It could down allocate that
20 handler's own supply, to say to class three or class four,
21 right?

22 A. Yes.

23 Q. As appropriate, and make the handler pay the full
24 class one on all the milk that it purchased, right?

25 Now, in return, it gets a blend back from the

1 milk it purchased, right?

2 A. Right.

3 Q. So maybe under those circumstances and in most of
4 those cases, it's to the handler's advantage to even draw
5 on the pool by allocating all of that classification,
6 right?

7 A. Right.

8 Q. But that's not necessarily violating the --
9 because that's voluntary, it's not violating the concept
10 that the handlers -- the producer is obligated to pay for
11 its own milk, or account to it to the pool, right?

12 A. It is not.

13 Q. All right. Now, you -- now, I want to talk about
14 another aspect. Let me ask it this way. Let me just start
15 it at this basis.

16 You are not suggesting, are you, that a decision
17 to -- of whether or not to regulate producer/handlers,
18 forget the idea of the purchase issue for the moment, okay,
19 but just assuming that we're beyond that, I don't think we
20 are, but just for this example that we're looking at this.

21 You're not suggesting that the Secretary make a
22 decision on whether or not producer/handlers be regulated
23 based upon their level of efficiency or inefficiency, are
24 you?

25 A. No. But I reflect back on the line of

1 questioning by Mr. Christ and say, you know, putting two
2 bad apples doesn't make a good apple. So, no, I don't
3 think efficiency is a relevant criteria, but at the same
4 time, I think it certainly is a consideration in how you
5 regulate the market.

6 Q. Now, I want to talk about a situation though that
7 I think you've mentioned this time and again, and there was
8 some lack of clarity, at least to me, which may mean it was
9 clear to everyone else, but it was a lack of clarity, and
10 that is this issue of risk.

11 I think you've indicated that several times, a
12 producer who acquires the ability to process is taking the
13 risk of both ends, right?

14 A. Absolutely.

15 Q. All right. So if you have the risk at both ends,
16 does that mean -- what does that do to the overall risk of
17 the entity? I mean, is there a --

18 A. It increases it substantially.

19 Q. Okay. And then let's talk about that increase.
20 I mean, let's say that you've got a 60 percent risk of
21 losing money as a producer, and 60 percent risk of loss as
22 a handler, and you come together, okay. Does that mean
23 that you have a 1.2 percent risk or do you have -- I mean,
24 is that more of a compounding that occurs, rather than --

25 A. Sure, sure. You know, I look at it in a

1 different sense. When a producer takes on a processor
2 operation, as we've seen here, he takes on the risk of
3 losing accounts in marketing. And that's an entirely new
4 risk to him, and is a cost to his operation. If that risk
5 didn't exist, you know, he could -- sure, he could go ahead
6 and make the decision to -- and we'd see a lot more
7 producer/handlers than we do, if there wasn't the
8 combination of the increased expertise that a firm has to
9 have, in both production and processing, and their
10 willingness to take on the additional risk involved in the
11 marketplace.

12 Q. It goes back to that old expression, if it was
13 easy, everybody'd be doing it, right?

14 A. Exactly, yes.

15 Q. And now, talking about that, economically there's
16 a cost to risk, right?

17 A. Yes.

18 Q. But it's not necessarily quantifiable; is that
19 right? I mean, in the sense of a dollar. For example, --

20 A. That's right. It's not necessarily quantifiable.

21 Q. We have in this record a gazillion statistics
22 that talk about spreads between class one and some other
23 number of blend or whatever, right, and that's quantifiable
24 in some way, maybe whether it's accurate or not in the over
25 scheme, but it's quantifiable, right?

1 THE COURT: Excuse me a second. Mr. Christ,
2 could you whisper a little bit quieter, please.

3 Mr. Yale, I'm sorry.

4 MR. YALE: That's quite all right.

5 Q. (By Mr. Yale) And so the situation is, is that
6 you've got this extra risk of being integrated, and you've
7 got this quantifiable number, I think isn't one of the
8 difficulties conceptionally that somehow or another
9 equating the one so that -- to see whether it offsets the
10 other or not?

11 A. That's a very difficult process.

12 Q. All right. But in economics in a larger scheme,
13 we're able to see whether there's -- that kind of quality
14 is occurring, right?

15 A. We should be able to see it in market shares,
16 growth, entrance and so forth.

17 Q. And in fact, that goes back to my earlier line of
18 questions, is that what's going on here with that
19 arbitrage, right?

20 A. Right.

21 Q. That arbitrage takes into account the cost of
22 that risk, right?

23 A. Yes.

24 Q. And factors it in with this other, right?

25 A. Right.

1 Q. I want to go back to my football analogy, okay,
2 and we -- you're not supposed to use court analogy, but I'm
3 going to use it.

4 But you know, you're sitting there and we're
5 looking at our Buckeyes and these people up north this
6 Saturday, and you know, all the papers, the local papers
7 are having all of these statistics and I happen to get on
8 the bubble line where people just to the north are
9 Wolverine fans, and we forgive them for a while and we're
10 the others, and there's these tables, and they say, this
11 quarterback has this quarterback percentage or
12 qualification, and they've got the lineman average weight
13 is this and the other, right?

14 And we use that to say sometimes they have an
15 advantage or not, right?

16 A. Right.

17 Q. So if I have a highly qualified quarterback, a
18 number one quarterback, or maybe a top running back or
19 something, does that necessarily equate that when the game
20 happens, that that's who's going to have the victory, that
21 that's quarterback's on?

22 A. Absolutely not.

23 Q. And why is that?

24 A. Well, there are a lot of other factors that
25 influence the outcome of a game.

1 Q. And are all of those quantifiable in terms of
2 weight and speed?

3 A. No.

4 Q. And isn't that the same situation here with the
5 producer/handler?

6 A. Absolutely.

7 Q. But in the free market of competition, in a
8 playing field that's equal to producers and processors,
9 where they can decide whether they want to be in it or not.

10 A. Yes.

11 Q. Play that out and those costs and those benefits
12 get shook out in the system, then the result is that,
13 right?

14 A. Yes.

15 MR. YALE: Your Honor, while I still have the
16 ability to sit down coherently, I'm finished, thank you.

17 THE COURT: What do you mean sit down coherently?

18 MR. YALE: Because I can't speak coherently. You
19 ought to see me when I really collapse.

20 THE COURT: Okay. Mr. Beshore, you have another
21 question? Go ahead.

22 MR. BESHORE: Yeah, I've got one question.

23 EXAMINATION

24 BY MR. BESHORE:

25 Q. Dr. Knutson, if you've -- in a football game

1 between A & M and Ohio State or whoever it is, okay --

2 A. A & M and Texas is the one that's coming up.

3 Q. Okay. Good, Texas and A & M, okay, let's take
4 that one. If one team has 11 players and four downs, and
5 the other team has 10 players and five downs to make a
6 first down, is that an even contest?

7 A. No. No, it's not, but I don't know what
8 relevance is.

9 Q. Well, what if they get to pick which one they
10 want before the game starts. They don't know what the
11 other one's going to do, but they both get to pick which
12 one they want before the game starts, then is it an equal
13 contest?

14 A. Well, I don't know what the relevance of this is,
15 a hypothetical.

16 THE COURT: Based upon your choice, answer his
17 question if you know the answer.

18 THE WITNESS: I don't know the answer to the
19 question.

20 MR. BESHORE: Okay. Thank you.

21 THE COURT: Anyone else? You may step down.

22 THE WITNESS: Thank you.

23 THE COURT: It's 6:25. I'm willing to listen to
24 what people want to do next. Do we want to have another
25 witness, or do we want to call it a day?

1 I'm just looking around here, and I mean,
2 everyone is looking pretty tired. It's been a long day.

3 MR. YALE: Long day, Judge.

4 MR. UNIDENTIFIED: Mr. Yale has indicated yes.

5 THE COURT: I know we have another witness ready,
6 but --

7 MR. YALE: I'm going to tell you what Mr. Yale's
8 indicated right now, I am incapable of continuing this
9 trial in fairness to my client.

10 THE COURT: Well, I'm just looking around. I see
11 everyone seems pretty tired. We've only worked ten hours
12 today I noticed, and you can complain to the Secretary if
13 you want, but we've had a series of nine and a half and ten
14 hours days. Tomorrow, 8:00 a.m. till 11:00 a.m.
15 approximately.

16 Thank you.

17 (Whereupon, the proceedings recessed at 6:27 p.m., to
18 reconvene on November 21st, 2003, at 8:00 a.m.

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